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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. It updates Research Paper 00/69, 12 July 2000.

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Summary of main points

- Between January 1999 and March 2001 the typical price of a litre of unleaded petrol in the UK rose from 62.9 pence to 74.9 pence – a rise of 12 pence or 19%. The retail price reached a high-point in July 2000 of 84.7 pence per litre.

- In March 2001 the typical price of 74.9 pence included 46.8 pence in excise duty, 11.2 pence in VAT and a pre-tax price of 16.9 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 March 2001 the overall cost of motoring was 4.1% 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.

CONTENTS

I Introduction

Between January 1999 and July 2000 the typical price of a litre of unleaded petrol in the UK rose from 62.9 pence to 84.7 pence – a rise of 21.8 pence or 35%. By March 2001 the price per litre had fallen by 12% to 74.9 pence. The price of petrol includes the raw material cost, distribution costs, wholesaler and retailer margins, excise duty and VAT. In March 2001 the typical price of 74.9 pence included 46.8 pence in excise duty, 11.2 pence in VAT and a pre-tax price of 16.9 pence. Based on the spot market price for unleaded petrol in London, the raw material content of the price was around 18 pence a litre. 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 private motorists and hauliers, including a public campaign in summer 2000 that drivers should boycott petrol stations. Despite the patchy response to this campaign, panic buying and blockades of refineries caused widespread shortages across the country by mid September. In his November 2000 Pre-Budget Statement, the Chancellor Gordon Brown announced that duty rates on all fuels would be frozen initially up to April 2002.[1] He went on to propose cutting duty rates on both ultra low sulphur petrol and ultra low sulphur diesel in the March 2001 Budget – by 2 pence and 3 pence a litre respectively – changes he confirmed in his Budget speech on 7 March 2001.[2]

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.[3]

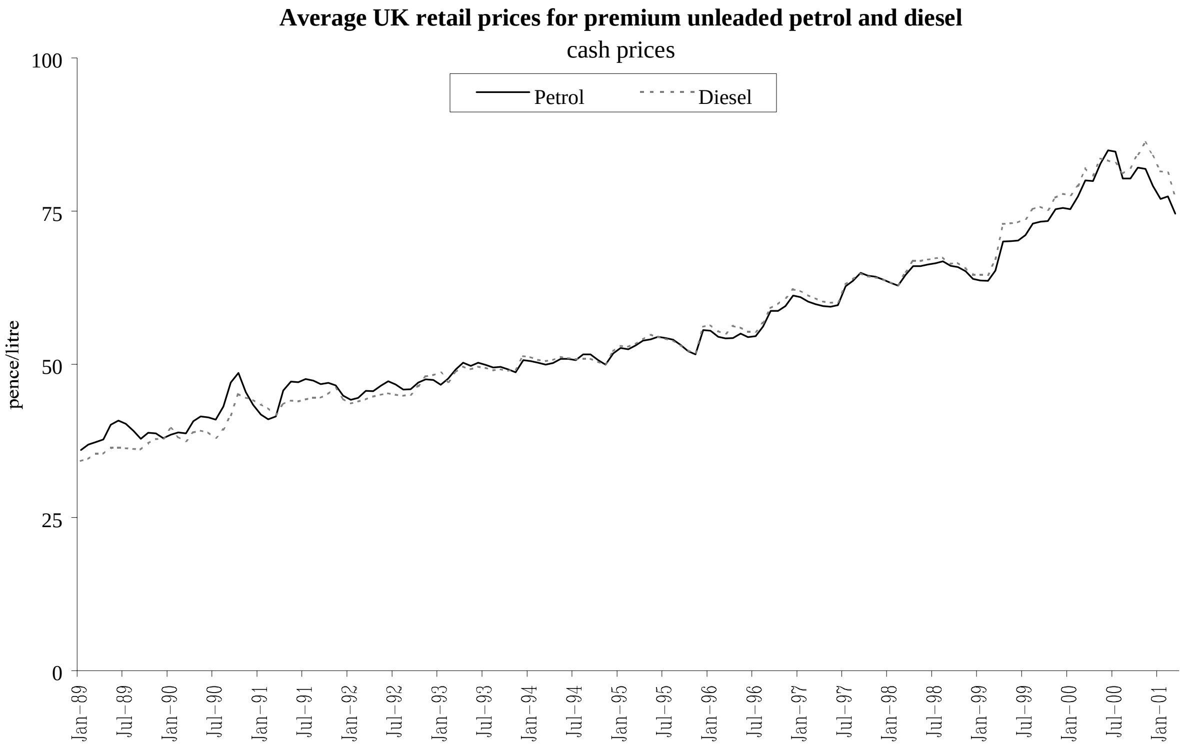
1 HC Deb 8 November 2000 cc 321-2
2 HC Deb 7 March 2001 c 303
3 *The Road Haulage Industry: costs and taxes*, Research Paper 99/42. The paper is published on the Library's internet site at: www.parliament.uk/commons/lib/research/rp99/rp99-042.pdf

II Fuel prices and the cost of motoring

A. Fuel prices

1. Trends in prices

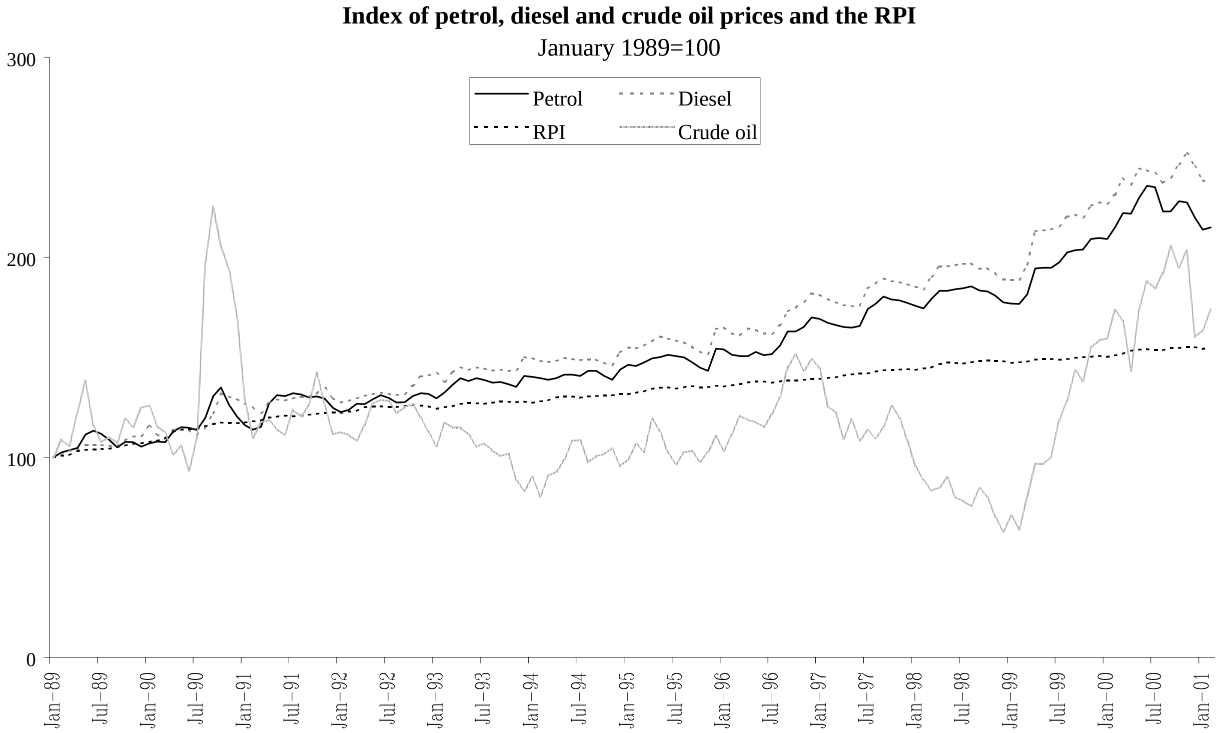
Between January 1989 and March 2001 the average retail price of unleaded petrol increased by 107% and diesel by 126%.[4] This represents price rises over and above the increase in the general price level of 48% for petrol and 50% for diesel. This is despite recent falls in fuel prices of around 10%. The chart below illustrates the change in the price of fuel over this time.



The following chart shows index values for petrol, diesel and crude oil prices[5] 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 220% between early 1999 and September 2000.[6] This resulted in an increase of

4 *Oil datasheet 12*, Institute of Petroleum
5 North Sea crude prices
6 *Oil datasheet 14*, Institute of Petroleum

around 12 pence/litre for both petrol and diesel.[7] The 25% fall in crude prices between November 2000 and January 2001 coincided with a reduction in fuel prices of almost 5 pence/litre.



2. Motorists' views and public opinion

Not surprisingly, surveys of motorists show a strong feeling against increases in the price of fuel. Different surveys put the net support for the fuel duty escalator at -82%[8] and -89%.[9] 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.[10]

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

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7 Excludes duty increases but includes additional VAT due to pre-tax price changes
8 *The 1999 Lex report on motoring*, Lex Service plc
9 *RAC report on motoring 2000*, RAC
10 ibid.

important. The cost of fuel was deemed relatively more important by people who live in rural areas, those with lower incomes and younger people.[11]

Soon after the fuel blockades had ended an NOP survey asked what the Chancellor should spend any surplus on in the run-up to an election. Given a number of options 30% opted for a 7 pence per gallon cut in fuel duty. This was somewhat less popular than a £2.5 billion increase in spending on public services (40%), but compared favourably to a £5 per week increase in the state pension (23%) and a 1 percentage point cut in income tax (5%).[12]

MORI conducts regular surveys on what people think are important/the most important issues facing Britain. At the end of September 2000 petrol prices/fuel ranked second behind the NHS/hospitals with 17% saying it was the most important and 31% including it as important or the most important issue. Education/schools was included by 30%of those surveyed and law and order by only 13%.[13] People's perception of the importance of fuel prices has subsequently fallen. By December 2000 3% thought it was the most important issue. The latest survey is from April this year when only 1% said that it was the most important and 7% included it as important or the most important issue.[14]

3. International comparisons

The latest fuel prices for EU Member States are shown below. At 30 April 2001 the UK had the highest road fuel prices. The price of petrol and diesel were 12% and 48% higher than the EU average respectively. The price of petrol was almost three times that in the US.[15] There is some evidence that the price gap is closing. Before the Budget 2001 duty reduction the price of petrol and diesel were 14% and 51% above the EU average respectively. The *EU Oil bulletin* showed that on 23 April 2001 premium unleaded petrol was more expensive in the Netherlands. This was the first occasion for some considerable time that the UK did not have the most expensive petrol. The situation was reversed the following week.

11 *The Great British motorist 2000,* AA
12 *Eight point lead for Tories,* Channel 4 News 23 September 2000
13 *Political attitudes in Great Britain for September 2000,* MORI
14 *Political attitudes in Great Britain for December 2000 and April 2001,* MORI
15 March 2001 figures. *Oil Market Report*, International Energy Agency

Road fuel prices, EU members, 30 April 2001
£/litre

	Premium unleaded (95 RON) petrol	Diesel
Austria	0.59	0.48
Belgium	0.67	0.49
Denmark[(a)]	0.73	0.56
Finland[(a)]	0.69	0.50
France	0.69	0.51
Germany	0.68	0.51
Greece	0.52	0.40
Ireland	0.52	0.47
Italy	0.68	0.54
Luxembourg	0.54	0.43
Netherlands[(a)]	0.76	0.51
Portugal	0.57	0.40
Spain	0.53	0.43
Sweden[(a)]	0.69	0.54
United Kingdom[(a)]	0.77	0.78
EU average	0.69	0.52

Notes: Prices converted to sterling on basis of exchange rates on 30 April 2001
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. UK price on In the first quarter of 2000 the UK had the highest diesel price of all OECD countries and the second most expensive petrol, after Norway.[16]

[16] *Energy prices & taxes, quarterly statistics, first quarter 2000,* 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

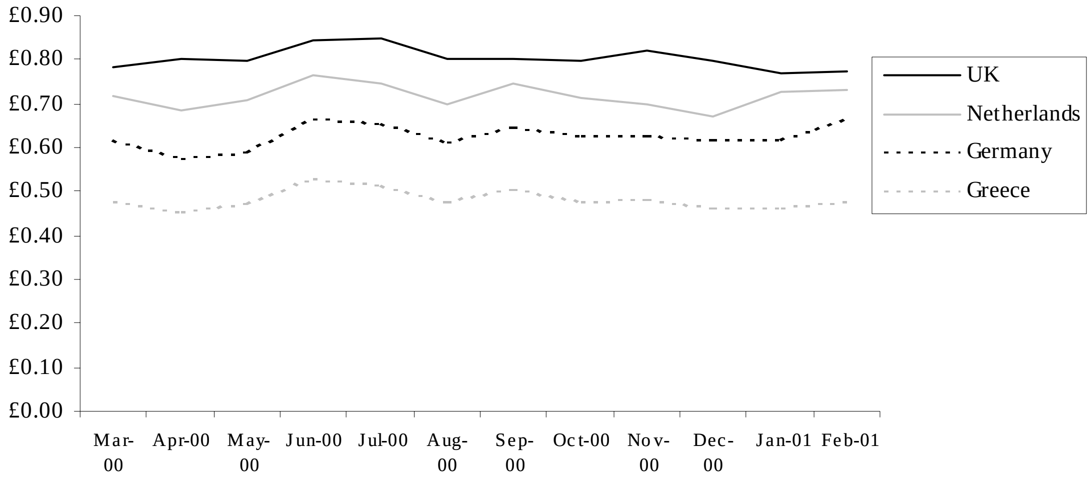
(a) Premium unleaded petrol (95 RON)

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.[17]

The following chart shows trends in monthly petrol prices for the UK and three other countries that broadly represent high, average and low cost countries. The gap between the UK and the other countries grew following duty increases in Budget 2000. There has been a clear reduction in the gap with the Netherlands and Germany since late last year.

Average mid-month petrol prices, selected EU countries



17 Based on annual averages; ibid.

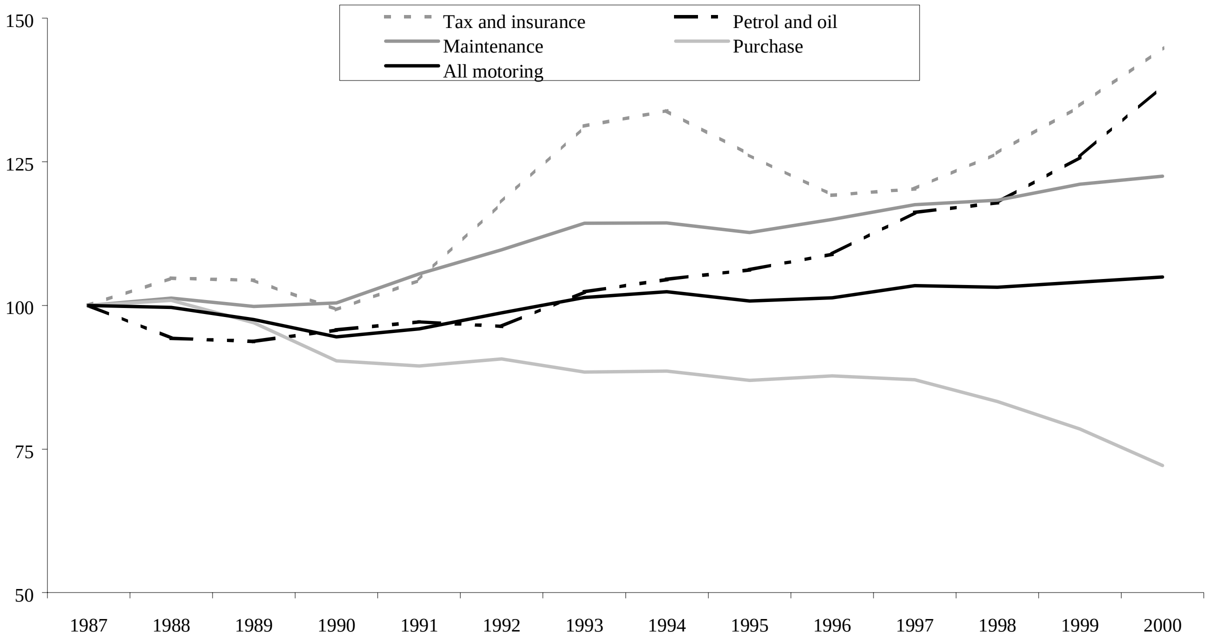
B. Motoring costs

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 March 2001 the overall cost of motoring was 4.1% higher, in real terms, than in 1987.

Real index of motoring costs, by type, average annual figures 1987 to 2000

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 a similar amount 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 in January 2001 cost just over £600.[18] This is £100 higher than in January 2000 and around two-thirds higher than the January 1997 level.[19]

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18 Includes Insurance Premium Tax

19 *British insurance premium index,* January 2001 This is published on the Automobile Association's internet site at: www.theaa.co.uk/insuranceandfinance/insuranceindex/index.asp

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 March 2001.[20] The real increases over this time were 22% for bus/coach fares and 23% for rail fares compared to 4.1% for motoring.

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, the latest figures 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

[20] NS database, series DOCW, DOCX

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, super-unleaded and ultra low sulphur 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 2001 Budget, the rate of duty on ultra low sulphur petrol and diesel is 45.82 pence per litre. The rate of duty on unleaded petrol was temporarily reduced from 48.82 pence per litre to 46.82 pence per litre, but will revert to 48.82 pence from 15 June 2001. This is to cover the period of transition to ultra low sulphur petrol, which is not yet available nation-wide.[21]

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 March 2001 taxes represented around 77% 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 (a)	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%
Jan 2001	76.85	16.58	48.82	11.45	60.27	78.4%
Mar 2001 (b)	74.85	16.88	46.82	11.15	57.97	77.4%

Note: (a) Includes raw material and refining costs, distribution charges and traders' margins.
(b) Retail price figure is provisional.

Sources: DTI, *Digest of UK Energy Statistics* , 2000 table 9.15
DTI Energy Statistics on the internet at http://www.dti.gov.uk/energy/energystats/energystats.htm (table 6.1)
HM C&E, *Annual Report 2000* , tables on the internet at http://www.hmce.gov.uk (table K1)
HM C&E, *Budget Notice* , BN 107/01 7 March 2001

21 In the March 2001 Budget it was estimated that ultra low sulphur petrol was already available at 93% of filling stations.

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 2.4% of GDP in 2000/01 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. 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.

The increase in receipts between 1999/00 and 2000/01 in real terms is very small. This reflects the ending of the fuel duty 'escalator' from the Spring 2000 Budget onwards. Revenues from oil duties are expected to be lower in both cash and real terms in 2001/02 than in 2000/01. This is principally because of the freeze in duty on unleaded petrol and the reduction in duty on ultra low sulphur petrol and diesel.[22]

Net Receipts of Hydrocarbon Oil Duties

Financial year	At cash prices (£ billion)	At 1999/00 prices (a) (£ billion)	Per cent 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	18.7	2.2%
1997/98	19.5	20.6	2.4%
1998/99	21.6	22.2	2.5%
1999/00	22.5	22.5	2.5%
2000/01 (b)	23.0	22.6	2.4%
2001/02 (b)	22.5	21.6	2.3%

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

Sources: NS - CSDB database (series ACDD and BKTL)
HM Treasury, Budget 2001, HC 279 2000-01 tables C3 & C7

Oil duties only represent one form of taxation on road users. In addition to the £22.5 billion raised by oil duties in 1999/00, the Exchequer also collected:

- some £5.8 billion in VAT relating to motor vehicles and road fuel[23]
- some £4.8 billion in vehicle excise duty[24]

22 Duty on unleaded petrol was temporarily reduced by 2 pence per litre between March and June 2001 until nationwide supplies of ultra low sulphur petrol could be guaranteed.
23 Source: Library estimate based on NS – CSDB database series CDDY & CCQI
24 Source: HM Treasury, *Budget 2001*, HC 279 2000-01 table C7

- some £2.3 billion in income tax on company cars and fuel[25]
- some £0.7 billion in employers' class 1A national insurance contributions on company cars and fuel[26]

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 1999/00.[27] 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.[28]

25 Source: Inland Revenue, *Inland Revenue Statistics 2000* table 4.5
26 Source: GAD, *Report by the Government Actuary on the draft up-rating orders*, Cm 4587 appendix 6
27 Source: HM Treasury, PESA 2001/02, Cm 5101 table 3.5
28 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

C. The introduction of a road fuel 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.[29] 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 November 1993 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.[30] 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.[31]

In his summer 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. The extraction of aggregates - including stone, sand and gravel - involves significant environmental costs and damage to the landscape, which may go beyond that recognised in the scope and level of the landfill tax. Too little is also being done to discourage water pollution. The environmental case for charges on polluters needs to be examined carefully. After a period of consultation, I will return with any proposals in those two areas in my next Budget.
>
> Existing taxes, including our excise duties, must also advance the Government's environmental objectives. So to reduce pollution, lorries and buses that meet low

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29 HC Deb 16 March 1993 c 183

30 HC Deb 30 November 1993 c 937

31 HC Deb 26 November 1996 c 167

> 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.[32]

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 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.[33]

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

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[32] HC Deb 2 July 1997 c 311

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

> 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.[34]

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-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.[35]

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

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

[35] HC Deb 17 March 1998 c 1110

> of carbon a year by 2010. The future of the road duty escalator will be considered each year in the Budget.[36]

Excise duty on tobacco products has also been subject to a duty escalator in recent years. This was introduced by the Conservative Government in November 1993 at a rate of 3% in real terms.[37] Following the General Election, the Chancellor Gordon Brown announced that duties on tobacco - except hand rolling tobacco - would be increased by around 8% from 1 December 1997, and that the duty escalator would be increased from 3% to 5% for future Budgets.[38] In the March 1999 Budget tobacco duties - with the exception of hand rolling tobacco - were increased by 6.3% in line with the escalator.[39]

The decision to increase fuel duties well in excess of inflation over this period raised considerable sums for the Exchequer:

> **Lord Lipsey** asked Her Majesty's Government: What revenue would have been foregone since 1992 from duty on petrol and diesel fuel excise duties if those duties had been increased in line with the retail price index.
>
> **Lord McIntosh of Haringey:** HM Customs and Excise's estimate of the revenues that would have been foregone since 1992 had petrol and diesel fuel duties been increased in line with the retail price index is shown in the table.

Financial year	£ billion revenues foregone
1992-93	0.2
1993-94	1.4
1994-95	2.7
1995-96	3.9
1996-97	5.0
1997-98	6.6
1998-99	8.4
1999-00	9.4

> The estimates include VAT and take account of expected changes in the pattern of consumers' expenditure as a result of the lower duty increases.[40]

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36 HC Deb 24 March 1999 cc 257-258W The estimate that greenhouse emissions should be cut by between 2 and 5 million tonnes of carbon is based on the *1997 National Road Traffic Forecast*, produced by the Department of the Environment, Transport and the Regions (HC Deb 24 March 1999 c 257W & HM Treasury, *Budget 99*, HC 298 March 1999 Table 5.1)

37 HC Deb 30 November 1993 c 937

38 HC Deb 2 July 1997 c 311

39 Both the Conservative and the Labour Government have not applied the escalator consistently to hand rolling tobacco, for fears of encouraging the considerable smuggling trade in this product.

40 HL Deb 1 November 2000 cc 101-2WA

D. The withdrawal of the road fuel escalator

In their 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 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.[41]

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 …

[41] IFS, *The IFS Green Budget: Commentary 76*, January 1999 p 90

> 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.

In both cases, the author argued, changes in behaviour were motivated not by price signals, but other factors – concerns about health in the case of cigarettes:

> 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 …

Given the fact that driver behaviour appeared relatively resistant to the price of petrol, the author went on to suggest there was no single method for cutting congestion:

> 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 … 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.[42]

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.[43] 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**

[42] "Taxation road to nowhere", *Financial Times*, 2 September 1999

[43] HC Deb 9 November 1999 cc 889-890

> **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.[44]

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. 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

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[44] *Pre-Budget Report* Cm 4479 November 1999 p 106 The Government also announced at this time that the duty escalator on tobacco 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 (*op.cit.* p 94).

> spending on transport, even if it were possible to guarantee higher spending, this new development in taxation policy is not very appealing.[45]

Following this announcement, in the March 2000 Budget duty rates were only increased in line with inflation.[46] Perhaps 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.[47]

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[45] IFS, *The IFS Green Budget : Commentary 80*, January 2000 pp 109-110

[46] HC Deb 21 March 2000 c 868 Road fuel duties, as with duties on fuel and tobacco, are increased in line with the projected increase in the Retail Price Index over 12 months to the September following the Budget, which was projected to be around 3.4% (*Budget 2000* HC 346 p 146, p 153).

[47] "Drivers see light at end of tunnel as taxes are cut back", *Times*, 22 March 2000

E. The 'fuel crisis' and the March 2001 Budget

Following the March 2000 Budget, further increases in petrol and diesel prices[48] resulted in complaints from both motorists and hauliers, launching a surprisingly successful public campaign which garnered support from both businesses and individual motorists for cuts in fuel duties.[49] One group of motorists proposed that drivers should boycott petrol stations on 1 August, and on a weekly basis thereafter, to force the Government's hand (the '*Dump-the-Pump*' campaign[50]). Response to this was patchy,[51] but panic buying and blockades organised by hauliers of refineries caused widespread shortages across the country by mid September.[52] Similar protests occurred in several other European countries.[53]

Further briefing material on the crisis was published at this time by the Institute for Fiscal Studies (IFS),[54] and the Scottish Parliament's Information Centre (SPICE).[55] The IFS estimated that "since May 1997 there has been a 42 per cent nominal increase in the price of unleaded petrol, three-fifths of it explained by tax." – though Martin Wolf, writing in the *Financial Times*, went on to comment, "there are excellent environmental and fiscal reasons for persisting with high taxes on petrol", and that farmers in particular already received considerable relief for fuel costs in the form of red diesel.[56] For its part the newspaper made a trenchant case against any fuel duty cuts:

> With astonishing arrogance, the self-appointed representatives of road hauliers and farmers gave the government a choice: either cut fuel duties or face further blockades and economic chaos. The deadline is November 13, five days after Gordon Brown delivers his pre-Budget report to parliament. The protesters will plainly find it more difficult to halt fuel supplies this time because the government, the police and oil companies are better prepared. But quick success against threatened disruption is not guaranteed. So Mr Brown must now focus on two principles, one political and one economic.
>
> First, the government must not give in to the demands of special interest groups seeking to hold the country to ransom. Second, any changes to motoring taxation

48 for a short analysis of the causes of this price hike see, "Oil's taxing times", *Economist*, 16 September 2000

49 "Motorists driven to despair over petrol price rises", *Financial Times*, 4 July 2000

50 The campaign still maintains an internet site at: www.boycott-the-pumps.com/index.php

51 "Business as usual for petrol stations as motorists dump the pump protest", *Financial Times*, 2 August 2000

52 "Panic as oil blockade bites", *Guardian*, 12 September 2000

53 "Governments in EU balk at French-style tax breaks on fuel", *Financial Times*, 12 September 2000 & "A French pox on them", *Economist*, 16 September 2000

54 Zoe Smith, *The petrol tax debate: briefing note no.8*, IFS July 2000 This is available on the IFS site at: http://www1.ifs.org.uk/consume/petrol.pdf

55 Patsy Richards, *Petrol crisis: Research Note 00-72*, SPICE 13 September 2000 This is available on the SPICE site at: www.scottish.parliament.uk/whats_happening/research/pdf_res_notes/rn00-72.pdf

56 "A choice of unpopularity or appeasement", *Financial Times*, 18 September 2000

> must be made within a context of rational tax, energy and environmental policies. Guided by these principles, there should be no question of reducing fuel duties on Wednesday. Politically, it would legitimise the protests, which obstruct the lawful activities of other citizens. It would encourage Opec to raise oil prices further, because oil-importing countries would show they are willing to offset the impact of price rises. And it might not even stop the protests. A small reduction in petrol duties would be derided.
>
> There is also little economic case for a reduction in fuel duty. Fuel taxes reduce carbon dioxide emissions in two ways: they have a short-term impact on the number of miles driven and, in the longer term, they encourage more fuel efficient vehicles. Cutting fuel duty to help vulnerable groups would be ill-targeted and ineffective. Farmers already receive a 93 per cent rebate for tractor fuel. Road hauliers operate in a competitive industry suffering from over-capacity. Cost savings from lower taxes would be passed on to customers. And the poorest people in rural areas do not own cars. Most other possible options, such as tinkering with vehicle excise duty, suffer from much the same problems and risk being seen as political tokenism.
>
> Mr Brown's task in the pre-Budget report is, therefore, to start the process of rationalising energy taxes. At present they are a mess. In a more coherent system, various taxes would be rebalanced. It makes little sense, for example, to tax carbon dioxide emissions produced by cars and lorries (about 25 per cent of the total) more heavily than emissions created from energy used in the home or in industry. If Mr Brown grasped this nettle, there would be a case for reducing the burden on motorists in the future. Until then, the government should tough it out.[57]

Diesel for agricultural use or other off-road use is subject to a substantially rebated rate of duty: at present "red diesel" as it is called is charged duty at only 3.13 pence per litre (the technical term for this product is gas oil).[58] This compares with a duty rate of 51.82 pence per litre on conventional diesel. Gas oil is eligible for agricultural, horticultural, marine, rail, power generation and industrial uses as well as commercial and domestic central heating.[59] It can also be used by hauliers for use in vehicle refrigeration units. When delivered from an oil warehouse normal 'white' diesel must have a red dye added to it, along with a chemical marker, before it can be sold as red diesel, so that its use can be detected. Red diesel can only be used in vehicles which are not generally used on the road, such as tractors, mowing machines and mobile cranes.[60]

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57 "Editorial: leave fuel taxes alone", *Financial Times*, 2 November 2000

58 HM Customs & Excise Budget Notice BN 62/00, 21 March 2000

59 There is no estimate of the total amount of red diesel used by farmers alone (HC Deb 31 October 2000 c 413W).

60 Schedule 1 (Excepted Vehicles) to the *Hydrocarbon Oil Duties Act 1979*, introduced by the *Finance Act 1995*, categorises the types of vehicle which are not considered to be road vehicles and which can, therefore, use rebated heavy oil as fuel when travelling on the public road. The intention of Schedule 1 is to limit the use of rebated heavy oil to vehicles that only use the public roads on very rare occasions.

At the time of the March 2000 Budget, the Government had announced a new duty rate on ultra low sulphur petrol – a relatively new fuel which delivered similar environmental benefits to ultra low sulphur diesel – itself the beneficiary of a lower duty rate introduced in August 1997. As it turned out, this paved the way for the Government's response to the fuel crisis in the November 2000 *Pre-Budget Report*. The *Budget 2000* document gives a short introduction to this issue:

> The transport sector remains a major cause of poor air quality although improvements in fuel quality and vehicle emission technology have led to a 50 per cent fall in transport related emissions over the last decade. The Government has played an important part in encouraging these changes through setting duty differentials to encourage the manufacture and take up of cleaner fuels.
>
> A favourable differential for unleaded petrol since 1987 has significantly reduced the use of leaded petrol - which was the major source of lead in the atmosphere - over the last decade. The success of this policy helped facilitate the phasing out of leaded petrol on 1 January 2000, in line with EU directives. As a result of these measures, lead emissions from traffic have been cut to almost zero, with older cars which are unable to use unleaded petrol switching to lead replacement petrol ...
>
> The Government has taken steps to encourage the manufacture and use of Ultra-Low Sulphur Diesel (ULSD) which reduces particulate emissions from existing diesel vehicles and allows the introduction of the latest diesel after-treatment devices, such as particulate traps. A 1 pence per litre duty differential in favour of ULSD was introduced in 1997. This was increased to 2 pence per litre in Budget 98 and 3 pence per litre in Budget 99. This policy has led to almost the entire diesel market converting to ULSD, way ahead of most other European countries.
>
> The use of duty incentives to move the diesel and petrol markets to ULSD and unleaded petrol can be counted as major successes in achieving better local air quality. A similar opportunity now exists for Ultra-Low Sulphur Petrol (ULSP). This reduces emissions compared to ordinary petrol and enables the introduction of cleaner vehicle technologies. The Government therefore intends to introduce a differential of 1 pence per litre in favour of ULSP relative to unleaded petrol from October 2000.[61]

A short description of the environmental benefits of ULSD was given in answer to a PQ in November 2000, reproduced below:

> **Mr. Webb:** To ask the Secretary of State for the Environment, Transport and the Regions if he will make a statement on the environmental effects of the large scale production of ultra-low sulphur petrol.

[61] HC 346 March 2000 pp 115-6

> **Mr. Hill:** Ultra-low sulphur petrol will have a direct benefit in reducing traffic related air pollutants. It will also facilitate the introduction of new fuel-efficient petrol engine technology. This emerging technology holds the promise of significant reductions in CO2 emissions from the vehicle fleet and will help ensure delivery of the voluntary agreements with the car manufacturers to improve new car fuel efficiency by 25 per cent. by 2008.
>
> The reduction of sulphur content of petrol from a maximum of 150 ppm to 50 ppm may result in increased energy consumption in oil refineries and hence CO2 emissions, due to the additional processing required. The extent to which this is the case is dependent on the configuration of each individual refinery, and on other factors such as processing lower sulphur crude. The overall effect is, in the short term, likely to be an increase of less than 2 per cent. in the CO2 emissions from refineries.
>
> Ultra-low sulphur petrol will become mandatory throughout the EU from 2005 and the Government's CO2 emission projections for 2010 already reflect the impact on refinery emissions of a reduction of sulphur levels in petrol. As more vehicles are introduced onto the market, fuel efficiency improvement is expected to be larger than increases in refinery CO2 emissions.[62]

Further details on the success of ULSD were published in a report by HM Customs & Excise just prior to the *Pre-Budget Report*.[63]

In his November 2000 Pre-Budget Statement, the Chancellor announced that duty rates on all fuels would be frozen initially up to April 2002:

> Today, like all countries, we are having to deal with the rise in world oil prices from $11 to $31. Because the Organisation of Petroleum Exporting Countries itself accepts that the world price is unacceptably high, our international efforts are geared to ensuring that production is raised and prices fall. Therefore, I recognise and understand the very genuine concerns that motorists and hauliers have ...
>
> The annual rise in the price of fuel that would be automatically introduced on Budget day would raise £560 million, putting petrol and diesel up by about 1½p a litre. I propose, at that cost of £560 million, a freeze in excise duties--an across-the-board duty freeze on all fuels that would initially last until April 2002, and, if the oil price remains at a high price between now and then, I can tell the House that there would be a duty freeze for a further year.[64]

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62 HC Deb 15 November 2000 cc 658-9W

63 HM Customs & Excise, *Using the tax system to encourage cleaner fuels: the experience of Ultra-Low Sulphur Diesel*, November 2000 published at: www.hmce.gov.uk/bus/info/graphics/ulsd-paper.pdf

64 HC Deb 8 November 2000 cc 321-2

Mr Brown went on to propose a reduced rate of duty for ULSP, and a corresponding cut in the duty rate for ULSD – as well as the abolition of the higher duty rate on lead replacement petrol:

> On top of the duty freeze that we had budgeted for in our fiscal arithmetic, the first of the proposals I will consult upon would itself involve additional expenditure of as much as £1,000 million and help to promote substantial benefit to the environment. Yesterday, we published a report showing the environmental benefits from the introduction of ultra-low sulphur diesel in reducing local air pollution. As a result of cuts we made in excise duty on ultra-low sulphur diesel, usage of that fuel has risen in Britain from 20 per cent. in 1997 to 40 per cent. in 1998 to 100 per cent. in 2000. It requires no change to be made in lorry and van engines. It now accounts for virtually 100 per cent. of the market for diesel in Britain today, and Britain is now leading in this cleaner diesel fuel.
>
> We now need to build on that environmental achievement. The widespread use of ultra-low sulphur petrol would further and significantly improve local air quality. Crucially, it would require no change to existing car engines. It is now time to make this cleaner fuel available in every petrol station in the United Kingdom and to make the use of this fuel, which requires no change in any car, cheaper for everyone. To do so I propose to cut the excise duty for ultra-low sulphur petrol so that it replaces unleaded petrol in every petrol station and at a lower excise duty. On 1 October, we reduced the duty on ultra-low sulphur petrol by 1p a litre.
>
> I propose from Budget 2001 a further reduction of 2p a litre--making a cut of 3p in total on all ultra-low sulphur petrol. Because it is right to maintain the proper balance between petrol and diesel, I propose also from Budget day to match the cut in ultra-low sulphur petrol with a 3p cut in excise duties on ultra-low sulphur diesel, which will go to all diesel users. I expect ultra-low sulphur petrol and diesel to account for 100 per cent. of the market next year. When the excise duty cut is introduced at Budget time, motorists using any petrol station in Britain should be able to benefit from this duty cut.
>
> It is by giving this incentive for cleaner fuels that we can both advance our environmental principles and ensure--with the 3p cut per litre in all ultra-low sulphur duty--a cheaper cleaner fuel available in every garage, a better deal for drivers and cleaner air across Britain. I can also announce that for all cars that still use lead replacement petrol--where there is no longer an environmental case for a higher duty rate--I propose from Budget day to end the differential and cut the excise duty by 2p a litre.[65]

At this time the Chancellor also announced a series of measures to help both the haulage industry and the farming sector, as well as motorists generally – through financial aid for restructuring, the introduction of a vignette system (whereby non-British haulage

[65] *op.cit.* cc 322-3

companies would pay a fee for using British roads) and reforms in VED for both lorries and cars. Details were published in the *Pre-Budget Report*.[66]

For some weeks before his announcement, it appeared that public concern about the tactics used by some protestors, and the impact of fuel shortages on the country, had undermined support for the blockade campaign. The *Financial Times* suggested that the reductions in duty announced by the Chancellor were larger than expected, and that as a result, the Government had “succeeded in dividing fuel tax protestors and heading off renewed protests on the scale of those that threatened to bring the country to a halt in September.”[67]

Nonetheless, following the Chancellor’s statement there was some concern about the availability of ULSP, and the extent to which all motorists would be in a position to benefit from the proposed cut in duty; estimates on its UK supply were given in a written answer at the time:

> **Mr. Brady:** To ask the Secretary of State for Trade and Industry what estimate he has made of the number of filling stations which (a) supply ultra-low sulphur petrol and (b) will supply ultra-low sulphur petrol by April 2001.
>
> **Mrs. Liddell:** The Department does not hold information on the number of petrol retail outlets in the UK selling ultra-low sulphur petrol (ULSP). According to HM Customs and Excise data, ULSP currently constitutes around a third of petrol released for consumption in the UK. Future levels of supply for ULSP will be a matter for individual companies to determine.[68]

By mid-January it was estimated that ULSP account for 47.8 per cent of all petrol released in the UK,[69] and the Government reported progress the following month:

> **Mr. Russell Brown:** To ask the Chancellor of the Exchequer what progress is being made on the introduction of ultra-low sulphur petrol in the United Kingdom
>
> **Mr. Timms:** The Chancellor of the Exchequer announced in the pre-Budget report in November that the Government would reduce duty on ultra-low sulphur petrol (ULSP) on Budget day this year, in recognition of its environmental benefits, subject to consultation and it being widely available.
>
> The Minister for Transport and I met the major oil companies on 21 February to discuss this issue. On the basis of that meeting, I am glad to say that we believe that the oil companies are on track to meet their target to supply ULSP nationwide at their retail sites by the end of March. The Minister for Transport

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[66] Cm 4917 November 2000 pp 125-132
[67] “Chancellor offers fuel protestors bigger than expected tax cuts”, 9 November 2000
[68] HC Deb 16 November 2000 c 718W
[69] HC Deb 26 February 2001 cc 510-1W

> and I also met representatives of independent petrol retailers on 21 February. They operate over 5,000 retail sites across the country. Many are small businesses, often playing a vital role supplying rural and urban communities.
>
> Although some independents are already supplying up to 50 per cent. ULSP, their representatives indicated that they anticipate that it could take independent retailers longer to complete the nationwide transition to ULSP than for the major oil companies, because of constraints on the capacity of UK oil refineries. The independent retailers could move faster by increasing imports, but this might cause uncertainty in the wholesale and retail markets and would not necessarily be to the benefit of motorists. The Government's objectives are to ensure that everyone should be able to share the environmental benefits of ULSP, and the benefits of the duty cut associated with it. It is in the whole country's interests that these objectives are achieved, and achieved as smoothly as possible.
>
> Any decisions on actual duty rates will be taken and announced by the Chancellor in the Budget itself but, as a sensible measure that will be supported by independent petrol retailers to guarantee that all motorists would benefit from a cut in duty on Budget day, I can announce that the Government intend to match any reduction in duty on ULSP that is announced in the Budget with a reduction in duty on unleaded petrol for a temporary period until 14 June 2001. This will ensure that the introduction of ULSP across the country will happen in the smoothest way, and that car-drivers--especially in rural areas supplied by independent petrol retailers--will be able to benefit from any duty cut that is announced in the Budget for ULSP. We want to match nationwide availability at the major oil companies with all motorists benefiting from any duty cut at independent stations too.
>
> In this way we best achieve our aims set out in November--first, that the long-term benefits to the environment are achieved; second, that motorists would be able to benefit from a cut in petrol duty on Budget day; and third, that the benefit would go to all motorists in all areas.[70]

There were also concerns that any duty cuts would not be reflected in pump prices – either through the supposed rapacity of oil companies, or the lack of pricing flexibility afforded them, given so large a proportion of the final price represented tax[71] - an issue raised in two PQs shown below:

> **Mr. Jenkin:** To ask the Chancellor of the Exchequer what assessment he has made of the factors affecting the price charged by oil companies for (a) ultra low sulphur diesel and (b) unleaded petrol.

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70 HC Deb 26 February 2001 cc 511-2W

71 "Forecourt prices continue to inflame debate over taxes and profit margins", *Financial Times*, 6 January 2001

> **Mr. Timms:** The price charged by oil companies reflects the influence of a number of variable commercial and economic factors, including production and distribution costs, supply and demand on world oil markets, conversion rates against the US dollar, and taxation. The Government do not intervene in commercial price-setting.
>
> **Mr. Jenkin:** To ask the Chancellor of the Exchequer what measures he has put in place to ensure that fuel duty reductions on ultra low sulphur petrol, announced in the pre-Budget Statement, will be passed on to motorists.
>
> **Mr. Timms:** The Government do not intervene in commercial price-setting. The United Kingdom Petroleum Industry Association (UKPIA) has stated that it anticipates that the 2 pence per litre duty cut will be passed on to the consumer.[72]

In his March 2001 Budget speech on 7 March, the Chancellor confirmed the changes in VED proposed in his Pre-Budget Statement, as well as the two reductions in the duty rates for both ULSP and ULSD:

> In addition to the 1p cut in ultra-low sulphur petrol duty last October, the duty on ultra-low sulphur petrol will be further cut by 2p a litre. To make sure all motorists can benefit from this 2p cut, I will extend it to unleaded petrol until 14 June, by which time the industry says ultra-low sulphur petrol will be 100 per cent. available. The 2p cut for both ultra-low sulphur petrol and unleaded petrol will take effect at 6 pm this evening.
>
> Lead replacement petrol duty will also be cut--by a further 2p per litre. And because it is right to maintain the proper balance in the tax treatment of petrol and diesel, I propose to match the cut in low sulphur petrol with a cut in excise duties in ultra-low sulphur diesel for all diesel users of 3p a litre, to take effect from 6 pm this evening as well. The pre-Budget report launched the green fuel challenge. Industry was invited to submit plans for new, more environmentally friendly fuels. I can announce that duty will be cut radically on alternative fuels--a further 6p per kilogram duty cut on road fuel gases with effect from 6 pm tonight, and from next April, a 20 per cent. duty cut on bio-diesel. To allow the new industry to plan ahead, duty on road fuel gases will be frozen in real terms until 2004.[73]

Responses appear to have been mixed, as environmental campaigners have attacked duty cuts as being contrary to the Government's environmental principles,[74] whereas haulage and motorist organisations criticised them as being insufficient.[75]

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72 HC Deb 30 January 2001 cc 143-4W

73 HC Deb 7 March 2001 cc 303-4 Legislation to this effect is included in the *Finance Bill 2001* (specifically clause 1-3). These provisions were scrutinised by the Committee of the Whole House on 24 April 2001 (HC Deb 24 April 2001 cc 171-222).

74 "Campaigners say lower fuel duty goes against promise to adopt 'green' agenda", *Financial Times*, 8 March 2001

75 "Mixed response to fuel duty cuts", *Financial Times*, 8 March 2001

F. Summary

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

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
7.3.01 (b)	46.82	-4.1%	-2.4	Temporary cut of 2 pence per litre
15.6.01 (b)	48.82	4.3%	2.4	Reversal of previous cut of 2 pence per litre

Note: (a) Pence per litre change reflects increase in VAT from 1.4.91.
(b) In the March 2001 Budget it was announced that the duty on unleaded petrol would temporarily be cut by 2 pence per litre until 14 June 2001, the date by when it is expected ultra low sulphur petrol will be available on a nationwide basis. (ULSP duty was cut by 2 pence per litre in the March 2001 Budget.)

Sources: HM Treasury, *Budget Red Books* (various years)
HM Customs & Excise, *Annual Report* , 1998/99 table K1
HM Customs & Excise, *Hydrocarbon Oils: Increased excise duty* , Budget notice BN 62/00 21 March 2000
HM Customs & Excise, *Hydrocarbon Oils: Changes in duty rates* , Budget notice BN 107/01 7 March 2001

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 out-turn for the previous September.

G. 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.

Road Fuel Duties: March 2001

Country	Duty (pence/litre) (a)		VAT
	Unleaded petrol	Diesel	
Austria	26.26	18.35	20.0%
Belgium	32.14	18.38	21.0%
Denmark	33.70	21.81	25.0%
Finland	35.46	19.30	22.0%
France	36.36	23.85	19.6%
Germany	37.58	25.92	16.0%
Greece	18.78	15.43	18.0%
Ireland	23.99	20.91	21.0%
Italy	32.97	24.18	20.0%
Luxembourg	23.58	16.02	12%/15%(b)
Netherlands	38.48	22.68	19.0%
Portugal	18.33	15.58	17.0%
Spain	23.55	17.10	16.0%
Sweden	31.29	21.13	25.0%
United Kingdom	46.82	45.82	17.5%

Note: (a) Converted at £1= Euro 1.58
(b) 12% on unleaded petrol and 15% on diesel.

Source: *Oil Bulletin, duty and taxes March 2001, EC DG Energy and transport*

The next table illustrates the incidence of tax on a litre of unleaded petrol in each country. Both these tables use post-Budget 2001 duty rates. Over the last year the duty on unleaded petrol has increased in five of the EU states and only fallen in France and the UK.[76]

[76] Duty rates in national currency end of March 2000 to end of March 2001; *Oil Bulletin, duty and taxes* EC Directorate General -Energy and transport

Premium unleaded petrol: March 2001

pence per litre

County	Typical retail price	Pre-tax price	Duty	VAT	Total tax Amount	Total tax % of price
Austria	57.33	21.52	26.26	9.55	35.81	166.4%
Belgium	64.07	20.81	32.14	11.12	43.25	67.5%
Denmark	67.82	20.56	33.70	13.56	47.26	69.7%
Finland	70.55	22.36	35.46	12.72	48.18	68.3%
France	65.58	19.11	35.72	10.75	46.47	70.9%
Germany	65.93	19.26	37.58	9.09	46.67	70.8%
Greece	47.42	21.16	18.78	7.19	25.97	54.8%
Ireland	61.00	26.42	23.99	10.59	34.58	56.7%
Italy	66.72	22.63	32.97	11.12	44.09	66.1%
Luxembourg	50.26	21.30	23.58	5.38	28.96	57.6%
Netherlands	72.45	22.40	38.48	11.57	50.05	69.1%
Portugal	57.84	31.10	18.33	8.40	26.73	46.2%
Spain	51.33	20.70	23.55	7.08	30.63	59.7%
Sweden	64.66	20.44	31.29	12.93	44.22	68.4%
United Kingdom	74.89	16.92	46.82	11.15	57.97	77.4%

Note: (a) Converted at £1= Euro 1.58

Source: *Oil Bulletin, duty and taxes March 2001, EC DG Energy and transport*
Oil Bulletin 12 March 2001

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.[77] Without any subsequent agreement, these minimum rates remain in force – and no changes have been made since them. The following table shows these rates, along with the current duty rates in the UK with effect from Budget day (7 March 2001):[78]

[77] 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.

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

Rate of duty per 1,000 litres

	Minimum rate in ECU	Rate in £	Current UK duty rate
Leaded petrol	337 ECU	£212.31	£546.80
Unleaded petrol	287 ECU	£180.81	£468.20*
Diesel (DERV)	245 ECU	£154.35	£518.20
Heavy fuel oil†	13 ECU	£8.19	£27.40††
Liquid petroleum gas (LPG)†	100 ECU**	£63.00	£90.00
Kerosene for heating purposes	Nil	Nil	Nil
Heating gas oil	18 ECU	£11.34	£31.30

Converted at a rate of 1 ECU = £0.63
* The UK duty rate on unleaded petrol is to rise to £488.20 per 1,000 litres from 15 June 2001
† Minimum EU Duty rate on heavy fuel oil and liquid petroleum gas is per 1,000 kg
** LPG that is not used as a propellant may be charged a lower rate of duty (no less than 36 ECU), or charged a nil rate is used for heating purposes
†† Duty on fuel oil in the UK is charged per 1,000 litres

Under Article 10 of directive 92/82/EEC the European Commission has 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.[79] 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 within a particular category of product to reflect policy concerns (such as the UK's higher rate for superunleaded 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

79 EC draft 6793(97) 21 March 1997

> 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.[80]

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,[81] 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."[82]

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 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

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80 HM Customs & Excise explanatory memorandum, 21 May 1997 paras 8-10

81 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.

82 HM Customs & Excise explanatory memorandum, 21 May 1997 para 20

> 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.[83]

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.[84]

In a written answer on 13 December 2000 the Financial Secretary confirmed that "discussion of the draft Energy Products directive is on-going."[85]

There has been just one substantive development since this date: political agreement on the form of any future directive revising the complementary legislation – Council Decision 99/880/EC – which allows for Member States' individual derogations and reduced rates on mineral oils. A compromise proposal was issued by the Swedish Presidency in January 2001,[86] on which agreement was reached by ECOFIN on 12 February 2001.[87] In effect Member States have agreed that all derogations be limited in time, and that no further derogations should be made.[88]

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83 HM Customs & Excise supplementary explanatory memorandum, 10 December 1997 paras 5-6
84 European Standing Committee B 27 October 1999 cc 2-3
85 HC Deb 13 December 2000 c 174W
86 HC Deb 29 January 2001 cc 42-3W
87 HC Deb 26 February 2001 cc 513-4W
88 The short text of the proposal was deposited in the Library (HC Deb 8 March 2001 c 163W : Deposited Paper 01/604).

H. 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 taxes on different types of household and on households with different income levels. The latest results were published in the April 2001 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 1999/00, suggests that households paid some £11.3 billion in hydrocarbon oil duties (mainly on road fuel). This was equivalent to around £430 per household before VAT. The following table analyses the results by decile (i.e. tenth) of households ranked by equalised disposable income.[89] 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
1999/00

Decile of equivalised household disposable income	Average amount per household		
	£ per year	Percent of disposable income	Share of total
Lowest	223	4.1%	5.2%
Second	202	2.5%	4.7%
Third	203	2.1%	4.7%
Fourth	311	2.5%	7.2%
Fifth	403	2.6%	9.3%
Sixth	493	2.6%	11.4%
Seventh	535	2.4%	12.4%
Eighth	600	2.4%	13.9%
Nineth	677	2.1%	15.7%
Highest	678	1.3%	15.7%
All households	432	2.1%	100.0%

Source: NS, *Economic Trends*, April 2001 p53

[89] Equalisation 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.

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 Studies.[90] 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 of car ownership and usage, by area type

	Rural	London	Metropolitan	Large urban[a]	Great Britain
Percentage of households with a car[b]	84	62	61	67	71
Annual car mileage[c]	10,200	7,800	9,000	9,200	9,600
Public transport as a percentage of all journeys[c]	4	20	14	9	9

(a) Population over 250,000
(b) 1997/99 data
(c) 1995/97 data

Sources: *Focus on personal travel 1998, DETR*
National Travel Survey: 1997/99 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.[91]

Concern about the impact of 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

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90 Laura Blow & Ian Crawford, *The distributional effects of taxes on private motoring*, IFS Commentary No65, 1997 A summary is provided on the IFS site: www1.ifs.org.uk/consume/car_summ.shtml

91 for example see, *European Petrol Retailing*, Research Note 00/38 and, *Rural transport initiatives*, Research Note 01/48. This material is published on the Information Centre's internet site at: www.scottish.parliament.uk/whats_happening/research/subj_indx.htm

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."[92]

The proposal was debated 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.[93]

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.[94] 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.[95]

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."[96] 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."[97]

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

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[92] HC Deb 10 March 1981 c 773
[93] HC Deb 30 April 1981 c 937 This measure was implemented as section 4 of the *Finance Act 1981*.
[94] HC Deb 6 July 1981 cc 72-235
[95] HC Deb 14 July 1981 cc 1127-1136
[96] HC Deb 23 January 1995 c 99
[97] *op.cit.* c 100

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.

There are two further objections to charging a differential rate of excise duty on hydrocarbon oils used in rural areas. First, it would be difficult to administer, since at the moment, duty is levied when oil leaves the refinery, not at the point of retail sale.

Second, it would – at present – fall foul of European law. As mentioned above, under the current EU rates directive (92/82/EEC[98]) allows for Member States to set duty rates appropriate to their own circumstances, provided they are not lower than the minimum levels specified. There is specific provision under Article 9 of the directive for Portugal and Spain to charge duty at a rate lower than the EU mandatory minimum rates for products sold in the Azores and certain selected Greek islands. However, additions to this list, as with other changes to EU tax legislation, would have to obtain unanimous support from Member States.

Furthermore, this legislation is flanked by 92/81/EEC[99] which defines, chemically, the oils to be charged duty (ie, what products have to be charged at least the EU minimum rate for each category of fuel). Article 1 states, "Member states shall impose a harmonised excise duty on mineral oils in accordance with this directive" – which, it would appear, carry the assumption that each Member State will charge only one rate of duty on each mineral oil. The preamble to the Directive notes that some exceptions to this rule might operate: "whereas ... it is appropriate to permit Member States to apply on an optional basis certain other exemptions or reduced rates within their own territory where this does not give rise to distortions of competition"

Article 4 spells out the procedure by which States can do this (that is, charge a lower rate of duty that may or may not be lower than the EU mandatory minimum for that particular class of mineral oil). Council Decision 92/510/EEC of 19 October 1992[100] provided a first list of these derogations allowed under Article 4[101] - generally these deal with reduced rates for certain uses of oils (eg, in local public transport); the only territorial exemption appears to be for the regions of Val d'Aosta and Gorizia in Italy.

[98] OJ L 31.10.92 316/19-316/20
[99] OJL 31.10.92 316/12-316/15
[100] OJL 31.10.92 316/16-316/18
[101] This list has been superseded by Council Decision 99/880/EC of 17.12.99 [OJ L 23.12.099 331/73-331/77]

So, the UK could apply for a derogation for a lower rate of duty for petrol sold in one area, say Scotland (to do so without a derogation would be against EU law), although given the distortions this would create, it seems unlikely the Commission would agree.[102]

Stephen Timms, Financial Secretary, set out the Government's position on this question in a written answer in July 2000:

> **Mr. Russell Brown:** To ask the Chancellor of the Exchequer if he will investigate the feasibility of introducing different fuel duties in rural and urban areas.
>
> **Mr. Timms:** The Government have no plans to do so. Differential fuel duties would be difficult and expensive to administer. No new arrangements for differential rates of road fuel duty have been sanctioned by the European Commission since the completion of the single market.[103]

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.[104]

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,[105] 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.

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[102] A short discussion of this issue, and some schemes for rural aid to help with petrol costs, is given in Northern Ireland Affairs Committee, *Impact in Northern Ireland of Cross-Border Road Fuel Price Differentials*, 29 July 1999 Third Report HC 334 paragraphs 50-58 The report is published on the internet at: www.publications.parliament.uk/pa/cm199899/cmselect/cmniaf/334/33402.htm

[103] HC Deb 19 July 2000 c 183W

[104] *op.cit.* c 104

[105] M.Pearson & S.Smith, *Taxation & Environmental Policy : Some Initial Evidence*, IFS 1990

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."[106]

The issue was raised with the then Financial Secretary (now Paymaster General) 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.
>
> **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.[107]

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:

> 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.[108]

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

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[106] HC Deb 23 January 1995 c 104
[107] HC Deb 7 April 1998 cc 149-150W
[108] HC Deb 17 March 1998 cc 1109-1110 Details of how this extra funding would be spent were given in DETR Budget press notice 1, 17 March 1998.

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.[109] In addition over this period the Government has introduced a lower rate of VED for smaller vehicles, increasing the cc limit for eligible vehicles in a number of steps since the March 1999 Budget; the following summary is taken from the *Budget 2001* document:

> Budget 99 introduced a reduced rate of VED for cars with engines up to 1,100cc, benefiting 1.8 million car owners. In Budget 2000, the threshold of the lower rate of VED for existing cars was increased from 1,100cc to 1,200cc, resulting in a lower VED rate for some 2.2 million smaller cars. Owners of qualifying vehicles are currently being contacted by the Driver and Vehicle Licensing Agency and will receive a rebate in respect of their existing licences, backdated to March 2000.
>
> The Pre-Budget Report proposed extending the small car rate further to 1,500cc, subject to consultation with motoring organisations. **Budget 2001 cuts VED by £55 for cars with engine size between 1,200cc and 1549cc,** backdated to 1 November 2000, providing benefit to a further 5 million car owners. This new rate will come into force on 1 July 2001, and rebates will be paid to owners of qualifying vehicles in that month. Together with measures announced in Budget 99 and Budget 2000, this will mean that around a third of existing cars in total will qualify for the lower rate of VED for smaller engine cars.
>
> Budget 2001 goes further to shift tax away from ownership. **The Government has also decided to freeze all car VED rates until Budget 2002, which is equivalent to a cut in real terms of up to £5.** In addition, **VED on motorbikes will also be frozen in cash terms.** [110]

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.”[111] More recently the issue was debated at some length when the Committee of the Whole House scrutinised the clause in the *Finance Bill 2001* setting duty rates on hydrocarbon oils.[112]

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109 HM Treasury/DETR Budget press notice HMT/DETR1, 21 March 2000
110 HC 279 March 2001 p 113
111 Standing Committee H 9 May 2000 c 57 It was also the subject of a short debate in Westminster Hall on 24 October 2000 (HC Deb cc 31-38WH).
112 HC Deb 24 April 2001 cc 171-222