

Would a fuel duty stabiliser really be fair?

February 2011

Summary

With petrol prices at an all-time high, the government is under pressure to cut fuel duty as a way of reducing the price at the pump in the run up to the budget. This means using taxpayer's money to fix a problem that we cannot control – the long-term upward trend in oil prices - a highly irresponsible act in a fiscal crisis. The net result of such an action would be a further drain on public finances, and those lobbyists calling for it should be pressed on what further spending cuts or tax rises they would like to see instead. Using a fuel duty cut to bring pump prices back to December 2009 levels would cost the taxpayer almost £6bn in the first year alone.

In a new report commissioned by Green Alliance, the Policy Studies Institute (PSI)¹ examines the long-term impact on the public finances of the previous government's decision to abandon fuel duty increases. A key finding of the report is that there is a clear long term upward trend in crude oil prices (see Figure 1). Consequently, for a fuel duty stabiliser not to be a burden on the taxpayer, it needs to be based on the acknowledgement of a continued steady increase in petrol prices. The implication is that policymakers need to come clean about petrol prices continuing to increase rather than pretending this can change.

Can a stable price be set for petrol?

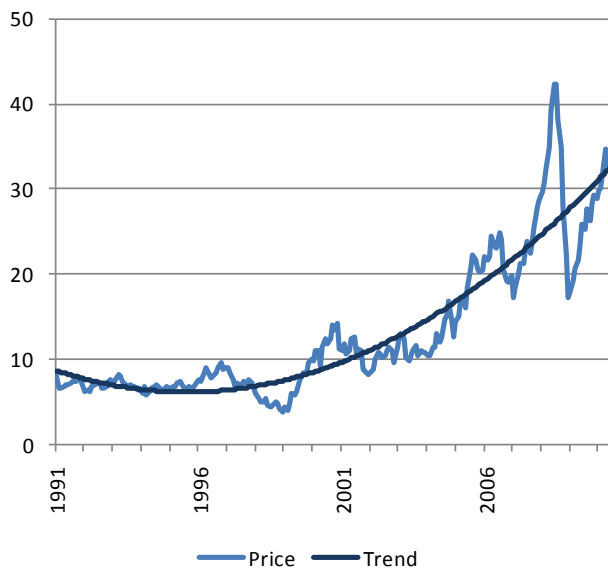
The Conservatives went into the election promising a 'fair fuel stabiliser'. People were told the stabiliser would cut fuel duty at a time of rising pump prices (though they were not told as much about how it might increase duties in the event of a fall in price). With the idea still very large in the minds of the public, who are understandably looking for relief from somewhere, the advice from the Treasury is that it is unworkable. What price do you stabilise petrol at when the trend in the global oil prices for the past two decades has been upward?

¹ Road transport fuel prices, demand and tax revenues: the impact of fuel duty escalator and price stabiliser. Roger Salmons, Policy Studies Institute. February 2011

Given that it is not in the government's power to affect global oil prices, should they decide to cut duty this year, they will then be faced with having to cut it by an even greater amount in subsequent years. Knowing that taxpayers will keep the price at the pumps artificially low will send completely the wrong message to oil producing countries, oil companies and petrol retailers, who will have a clear incentive to raise prices and profit margins in the knowledge that the taxpayer will fund the cost.

This is the reality of the demands of the motoring lobby and haulage industry. If the government decided to placate these groups with a tax cut, it will find it has a black hole in its finances that requires further spending cuts or a tax rise on something else.

Figure 1: Crude oil price (pence per litre)



Source: Quarterly Energy Prices: June 2010 (DECC)

How much would a fuel duty stabiliser cost the taxpayer?

We cannot put a precise figure on the cost. However 1p per litre on fuel duty raises around £540m per year. So, if the government wanted to 'stabilise' a price increase of 3p per litre, it would be losing around £1.6bn in revenue in that year. If the underlying price of petrol continued to rise, then next year's stabiliser would cost £3.2bn, compared to the situation where no stabiliser policy existed. Between December 2009 and December 2010, the petrol price rose by 13p per litre. A tax cut to compensate for this would cost near to £6bn.

During the fuel protests of 2000 the Labour government at the time responded by abandoning their original policy of increasing fuel duty by 6% above inflation every year. The PSI study reveals that if that policy had remained in place, an extra £100bn would have been collected by 2010. How that money could have been used is conjecture. However, as an example, by last year the additional revenue would have been sufficient to cut employer's National Insurance Contributions by a quarter or the basic rate of income tax by 3p. There would also have been environmental benefits, with total UK carbon emissions at 5% lower than current levels.

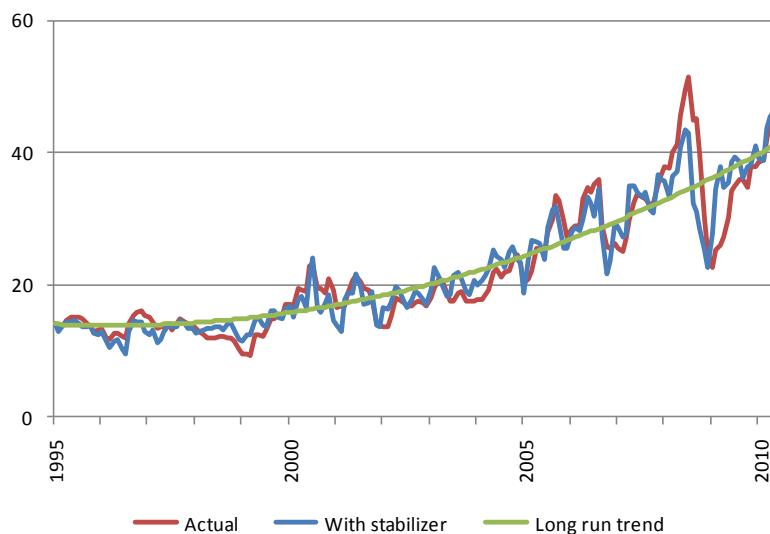
Is it fair?

Many households and businesses are feeling the impact of higher fuel prices, however the government's fiscal plans are impacting on all travellers. Train fares are already increasing and are expected to rise by 25% in the next four years as a consequence of government changes to subsidies announced in the Spending Review. It is patently unfair to give one set of travellers a tax break at this time. In terms of competitiveness for the haulage industry, the extra costs of fuel can be passed on: price rises are global so everyone is facing the same increases.

Government could still reduce price volatility without taxpayer's subsidy

If we accept that rising oil prices are here to stay then it is possible to design a fuel tax stabiliser that dampens some of the damaging volatility in the petrol price, whilst remaining revenue neutral for the taxpayer. PSI analysis illustrates that by using a formula based on recent historic price data to adjust fuel duty rates on a monthly basis, some of the worst peaks and troughs of price can be smoothed out. However, to ensure no taxpayer's subsidy is involved, the overall price of petrol would need to increase steadily, reflecting the long term trend in crude oil prices. Figure 2 below shows that such a stabiliser would have reduced the peak prices most of the time, but because there would be some time lag between known prices and adjusted duty rates, there would be occasions when price peaks or troughs are exacerbated.

Figure 2: Impact of stabiliser on the pre-tax price of premium unleaded petrol (p/litre)



Government should help us adapt to high fuel prices

Politically and economically it does not make sense for a government to use taxpayers' money to compensate one group of people for an ongoing global price trend. The sooner they and we accept that high prices are here to stay for the foreseeable future, the sooner we can adapt our transport systems and behaviours. It is this latter task where the government should be aiming its resources.