MOTOR FUEL DUTY (P.59/2000): REPORT

Presented to the States on 23rd May 2000
by the Finance and Economics Committee

STATES OF JERSEY

STATES GREFFE

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REPORT

The Finance and Economics Committee unanimously opposes this Proposition on the following grounds -

The Finance and Economics Committee wholeheartedly supports the statement made in the first paragraph of the Report accompanying the Proposition that “mere tinkering with the economy will not be sufficient to make a meaningful difference” to the gap between the Jersey rate of inflation and that of the United Kingdom.

However, it believes that this is precisely what the Proposition to reduce the duty on fuel is suggesting, **a mere tinkering with the economy which will not be sufficient to make a meaningful difference to the Island’s rate of inflation.**

Available evidence clearly indicates that the greatest impact on the inflation rate is **not** the duty on motor fuel. The recent “Report on inflation in Jersey” clearly states that there is no single cause and no single answer. Inflationary pressures have been building up for a number of years, and equally it will take some time for them to subside.

Addressing the problem in a fragmented, uncoordinated way is no way to manage the economy of the Island. This would almost certainly lead to a further escalation of the inflation rate.

The Finance and Economics Committee believes that the only responsible way in which to address the current unacceptable rate of inflation is to examine the problem as a whole, identifying the root causes and developing a sustainable strategy to combat inflationary pressures. An “Inflation Task Force” has been established to undertake this task. The process is well underway, with a number of action points to be addressed in a co-ordinated manner already having been produced.

A report and recommendations for action will be presented to the House before the summer recess.

Effect of the Proposition on inflation

Economic advice on the effects of the Proposition on inflation is clear. Assuming there is sufficient competitive pressure in the Island to ensure that the retail price of fuel quickly fell by the full amount of the duty reduction, the subsequent fall in the retail price index (R.P.I.) would be a “one-off” reduction only. Because the measure is a “one-off”, the reduction in fuel prices would drop out of the annual R.P.I. calculation after one year. If underlying inflation was, for example, 4.8 per cent, then for one year only the rate would be **massaged** down to a lower figure, but after one year it would revert to 4.8 per cent.

Such changes are cosmetic, as they do not address the more fundamental causes of inflation.

It is widely accepted by economists throughout the world that, to counter inflation in any meaningful way, the level of demand in an economy must be reduced. All effective deflationary fiscal policies reduce rather than increase the amount of disposable income available to consumers.

The removal of fuel duties would effectively be a £12 million tax break for consumers, which would lead to a boost in consumer spending of several million pounds. This increased spending would lead to further demand in the economy and would be inflationary rather than deflationary.

Not only should consumer spending be reduced but also, perhaps more importantly, government spending should be significantly reduced.

The Island has one of the highest vehicle densities in the world, and the policy of increasing fuel duties in recent years has been in support of initiatives to reduce traffic congestion and exhaust emissions, which are damaging to health and the environment. It should be remembered that this policy received the full support of States’ Members during the last three budget debates.

Support for the proposition would, at a stroke, not only overturn the policy of supporting initiatives to reduce traffic and pollution, but also go against the States strategic objective of broadening the tax base. This could well damage the reputation and credibility of the States.

Furthermore, any subsequent re-introduction of fuel duty, say in support of the Sustainable Transport Policy or other initiatives, would cause a greater upward effect on the R.P.I. than the perceived benefits of abolition.

Public sector wage demands

The Finance and Economics Committee does not believe that the removal of fuel duties in isolation would alter the expectations of employees during wage negotiations or reduce salary demands by £2.5 million per year. The removal of fuel duty would be seen as a one-off short-term measure and in no way the root cause of inflation in the Island. In any event, this measure is already too late to affect this year's salary negotiations. The abolition of fuel duty would impact directly on only one price in the retail price index basket of goods, whereas a whole package of measures designed to reduce overall demand more generally would be seen as meaningful long-term action, and as such would be more likely to result in downward pressure on future wage demands.

Quality of life for the poorest in the community

The Finance and Economics Committee supports the view expressed by the Fiscal Review Working Group, that adjustments to indirect taxation in favour of the less well-off is not the most appropriate way to assist those in need. Indirect taxation cannot be targeted away from just the less well-off in the community. The removal of fuel duty would, of course, benefit the less well-off to the extent that they are car owners, but car ownership and use is generally greater for the higher income households and the bulk of the benefit would therefore go to the better-off. It would be far more appropriate to support the less well-off by an integrated taxation and benefit system, as suggested by the Fiscal Review Working Group, rather that by the somewhat blunt instrument of the removal of indirect taxation.

Impact on States revenues

Contrary to the suggestion in the Report, that the Treasury would be £12 million better-off if fuel duty was removed, the revenue available to the Treasury would in fact be <u>£12 million per annum less than expected</u>. The £25 million additional income referred to in the Report and Proposition was an <u>income tax windfall</u>. There is no guarantee that this will continue on an annual basis, whereas the £12 million loss on fuel duty would be an ongoing commitment. It can be seen that over a ten-year period this would result in £120 million being lost from States revenues. This is a significant amount of revenue which the Island cannot afford to waste, particularly at a time of high inflation when the Strategic Reserve should be significantly increased. The notion that £12 million per annum is insignificant is not helpful when trying to combat inflationary pressures.

The well-being of Jersey residents

Extensive research indicates that an increase in the cost of motoring reduces car usage and fuel consumption; conversely, a reduction in costs will increase usage. Statistics in the Island **do not** indicate that Jersey is an exception to this rule.

The abolition of fuel duty would almost certainly encourage the increased use of motor vehicles, and completely overturn the accepted policy of applying fuel duty in support of health and environmental initiatives.

Additional traffic pollution and congestion are not considered to be beneficial to the well-being of Jersey residents who, it should be remembered, are not all car owners.

It is generally accepted that there is a continuing need to curb private motoring and to develop a more attractive public transport system. To address this issue in isolation from the initiatives outlined in the Sustainable Transport Policy would be irresponsible and short-sighted.

Serious about inflation

This one-off measure in isolation would in no way prove that the States is serious about tackling inflation. The Finance and Economics Committee believe that the only way for the States to prove it is serious about tackling the problem is to thoroughly examine the root causes of inflation and to consider all of the complex issues involved in a proper and responsible manner. Far from proving that the States is serious about tackling inflation, this one-off, short-term measure will send out the completely opposite message. The Inflation Task Force will shortly be finalising a comprehensive package of counter-inflation measures which will be presented to the House for consideration before the summer recess.

The tourism industry

There is no evidence to suggest that the abolition of fuel duty would provide a welcome boost for Jersey's tourism industry. It is not felt that the Island's fuel prices are a significant factor in the attractiveness of Jersey as a holiday destination. Indeed, it has been established that petrol prices do not figure in consumer responses of why tourists choose holiday destinations.

United Kingdom residents, by far the Island's largest tourism market, cover far more mileage at home, and pay significantly more for their fuel than they do whilst on holiday in the Island. The cost of motor fuel for those visitors who actually do drive whilst they are in Jersey, probably just over a half, is an insignificant part of their holiday spend.

Since 1973, the duty on road fuel in the United Kingdom has increased ten-fold, whilst in Jersey during the same period there has been a duty increase of just over six-fold. The tax levied on a litre of unleaded fuel in the United Kingdom is 60.8 pence, compared to the Jersey duty of 21.7 pence. The average quantity of fuel used by the driving tourist on a week's holiday in Jersey is ten gallons. This would be a saving of approximately £9 on an estimated holiday spend of £700 per person.

Even with the high level of fuel duty in the United Kingdom compared to Jersey, the rate of inflation in the United Kingdom is half the Jersey rate. It is therefore difficult to see a strong link between fuel duty rates and high inflation, and even more difficult to believe that fuel duty is the main cause of the Island's high rate of inflation.

It is interesting to note that although the duty on fuel in Guernsey is exceptionally low, probably the lowest in Europe, the inflation rate in Guernsey rose from **2.4 per cent** in December 1999 to **3.8 per cent** in March 2000. A rise of **1.4 per cent** compared to a rise of **0.2 per cent** in Jersey for the same period.

In summary

The Finance and Economics Committee unanimously opposes the proposition to reduce the duty on motor fuel because -

- It would be tinkering with the economy in isolation without making a meaningful difference and is likely to add to inflationary pressures.
- It does not address the root cause of inflation.
- It would be a "one-off" cosmetic measure, which would manipulate the Retail Price Index for one year only.
- As a "one-off" it is not likely to influence wage negotiations. It is too late to influence negotiations this year.
- It overturns the accepted policy of applying duty to motor fuel in support of health and environmental initiatives and will evoke a feeling of fiscal instability.
- It goes against the States' strategic objective of broadening the tax base.
- Overturning the two above strategic policies would cast doubt on the credibility and stability of Government.
- It would not be a boost for the tourism industry.
- It would not improve the well-being of residents.
- A comprehensive package of measures is required to combat high inflation. This will be presented to the House before the summer recess.
- It would add several million pounds to consumers' disposable income.
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States revenues would be reduced by an <u>ongoing £12 million per annum</u>.