The Case for Freezing Excise Duties

Tom Clougherty & Gerard B. Lyons

- Inflation and tax increases are pushing Britain towards a cost of living crisis. At the forthcoming Budget, the Chancellor should once again freeze fuel and alcohol duties to avoid adding to that crisis.

- Raising excise duties in line with RPI would add 2.4% to a full tank of petrol, 2.2% to the price of a typical bottle of wine, 3% to a case of beer, 3.1% to a standard bottle of whisky, and 3.4% to a similar bottle of gin.

- British excise duties are already high by European standards. Fuel duties are the seventh highest in Europe, wine and beer duties are the third-highest in Europe and spirits duties fourth-highest.

- Hiking duties would mean that tax (including VAT) made up 60% of the average price of a tank of fuel, 55% of the price of a bottle of wine, 68% of a can of beer, and more than 70% of a bottle of spirits. These costs fall disproportionately on lower-income households.

- There's a particular case for freezing alcohol duty: first, a Government review of alcohol duty is already under way; second, freezing alcohol duty would boost the hospitality industry, which has been particularly hard-hit by Covid-19; and third, lighter treatment of alcohol duty in recent Budgets has led to above-expected revenues.

- Fuel duty is also a key source of cost of living pressures, and will yield diminishing returns as we shift to driving electric cars. It should be phased out over the medium term, and replaced with a system of road pricing and an upstream carbon tax.

- We should also use the same measure of inflation across the entire tax and benefits system. It is hard to justify raising duties in line with RPI while tax thresholds and benefits only rise with CPI – a measure which is almost always lower.

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Introduction

The UK's excise duties on alcohol and fuel are expected to contribute more than £38bn to the Exchequer in 2021-22 – roughly 5.25% of the total tax take.[1]

By convention, these duties rise in line with the RPI measure of inflation at each Budget. However, this convention is not a hard-and-fast rule. In fact, the Chancellor has complete discretion over whether to raise excise duties and by how much. Fuel duty has been frozen since 2009, and alcohol duties were frozen across the board in March 2021 – the eighth year out of nine that duties did not entirely track RPI.

Given the cost of living crisis that Britain faces, the tax increases that have already been announced, and the fact that Britain levies very high excise duties by international standards, this note argues that the Chancellor should use his discretion again at the forthcoming Budget, and freeze these duties for the next tax year as well as the current one. There are also longer-term changes that would make these taxes fairer for everyone.

Context

It is hard to miss the cost of living pressures that are currently hitting Britain. The latest Consumer Price Inflation (CPI) numbers show prices up 3.2% from a year earlier; Retail Price Inflation (RPI) stands at 4.8%.[2] The Bank of England expects inflation to rise further in the short term, forecasting CPI above 4% in the fourth-quarter of 2021.[3]

Energy prices, in particular, look set to continue rising: the energy price cap went up by £139 on October 1, with analysts predicting a significant further increase in April, amounting to an extra £400 or more on bills.[4] Meanwhile, house prices rose at their highest monthly rate since 2007 in September.[5]

These inflationary pressures may prove transitory. The Bank of England expects CPI to fall back towards its 2% target in the second half of 2022. Nevertheless, in the meantime, rising prices are sure to put a squeeze on living standards – especially for poorer households, who spend a greater share of their income on essentials like food and energy.

This dynamic is not helped by policy choices the government has already made. The introduction of the 'health and social care levy' – a 1.25 percentage point addition to employee National Insurance Contributions – will cost the average full-time worker nearly £275 per year

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[1] Calculation based on HM Treasury, Budget 2021, Table C.5: Current receipts.
[2] Office for National Statistics, Inflation and price indices, August 2021 figures.
[3] Bank of England, Monetary Policy Summary, September 2021.
[4] Euronews, 'UK's Ofgem expects 'significant' rise for energy price cap in April', 8 October 2021.
[5] The Times, 'House prices rise at fastest pace for 14 years, says Halifax', 7 October 2021.

once it takes effect in April. The corresponding increase in employer National Insurance Contributions is certain to diminish future pay increases.

Freezing the personal allowance going forward will effectively remove another £80 from annual take-home pay from April. And, of course, many of the poorest households have just seen their weekly income fall by £20 a week, with the expiry of the pandemic-related uplift in Universal Credit.

The impact of raising excise duties

As noted above, the baseline assumption for excise duties is that they rise with RPI inflation (4.8% on the latest figures) at each Budget. If that assumption were put into effect this year it would mean:

- Spirits duty rising from £28.74 per litre of pure alcohol to £30.12 per litre;[6]
- Wine duty rising from £297.57 per hectolitre to £311.85 per hectolitre;
- Beer duty rising from £19.08 for each percentage point of alcohol content per hectolitre to £20; and
- Fuel duty rising from 57.95p per litre to 60.73p per litre.

Given the complicated way excise duties are applied, however, this doesn't tell you much about the impact on the typical consumer. Moreover, increasing the duty on a product has the simultaneous effect of increasing VAT, since VAT is applied to the price *including* any excise duty.

It is therefore best to look at the *total* tax increase on a range of typical products. In the examples below we base our calculations on: a 750ml bottle of supermarket Pinot Grigio (£6, 12.5% ABV); an 18-pack of 440ml cans of Carling Black Label lager (£12, 4% ABV); a 70cl bottle of Famous Grouse scotch whisky (£15, 40% ABV); a 70cl bottle of Gordon's gin (£14, 37.5%); and a full tank of unleaded petrol at the current average price of 136.8p per litre (the Vauxhall Corsa, currently Britain's best-selling car, holds 45 litres of fuel).[7] Assuming that excise duties rise in line with 4.8 percent RPI inflation:

- The bottle of white wine goes up by 13p (2.2%);
- The 18-pack of lager goes up by 36p (3%);
- The bottle of whisky goes up by 46p (3.1%);
- The bottle of gin goes up 48p (3.4%); and
- The full tank of petrol goes up by £1.50 (2.4%).

[6] The full schedule of alcohol duties can be found at HM Revenue & Customs, Alcohol duty rates from 1 February 2019.
[7] Average fuel prices taken from Allstar, UK fuel prices near me on 8 October 2021.

It is also interesting to note the 'tax share' of the price of each product. In each of the above cases, an RPI-linked increase in excise duty would add roughly one percentage point to the tax share of each product. This would mean the taxman received 55% of the price paid for the bottle of wine, 60% of the price of fuel, 68% of the price of beer, 71% of the price of whisky, and 72% of the price of gin.

How Britain compares internationally

The US-based Tax Foundation releases a set of 'tax maps' each year, which compare the levels of excise duty in the UK and EU member states.[8] According to the most recent editions, the UK already levies very high excise duties compared with its neighbours:

- Our beer duty is the third-highest in Europe, behind Finland and Ireland;
- Our wine duty is also the third-highest in Europe, again behind Finland and Ireland;
- Our spirits duty is the fourth-highest in Europe, behind Finland, Sweden, and Ireland;
- Our petrol duty is the seventh-highest in Europe, while we levy the highest duty on diesel of any European country.

Assuming no corresponding changes in other European countries, raising excise duties in line with RPI inflation at the forthcoming Budget would push us above Ireland to second place in the beer duty rankings, and into fourth place for petrol (leapfrogging Portugal, France, and Greece, but still behind the Netherlands, Italy, and Finland).

The future of excise duties

Excise duties are a useful revenue-raiser for the Treasury, but they are also a part of the tax system that could do with comprehensive reform.

Fuel duty revenues have fallen from 2.2% of GDP in 1999–00 to a forecast 1.3% of GDP this year.[9] That development owes much to the 1p cut in fuel duty announced at the 2011 Budget and the subsequent freeze in duty. However, fuel duty was *already* on a downward trajectory in the 2000s, and the trend is likely to accelerate significantly as we approach 2030, when the sale of new petrol and diesel cars is set to be banned.

The transition to electric vehicles will mean the government needs to find a new way to reflect the cost of driving (in terms of congestion, pollution, and wear and tear on the roads) in the tax system. Economically, the best option would be the adoption of dynamic road pricing to charge for road use and congestion, coupled with an upstream carbon tax to capture the environmental cost of electricity generation and the ongoing use of petrol/diesel.[10]

[8] Tax Foundation, Global Tax Maps.
[9] Office for Budget Responsibility, Fuel duties, Recent trends and latest forecasts.
[10] More immediately, it is worth noting that the haulage industry is currently facing rising costs and severe labour shortages; the government should avoid adding to the problem by pushing up the cost of fuel.

Alcohol duties – which have been levied since 1643 – are likely to be with us for rather longer. However, their structure is likely to change considerably in the years ahead. In September 2020, the Government launched a consultation that aimed to make alcohol duties simpler, more economically rational, and less administratively burdensome. The minister responsible, Kemi Badenoch MP, described the current system as 'complex – and arguably outdated' in her foreword to the call for evidence.[11]

The main issue at present is that alcohol duty consists of multiple taxes, each with a different structure and method of calculation. As one example of the inconsistencies that define the current system, take this comparison of the duty for a 4% ABV half a litre 500ml product (2 units of alcohol):

Product	**Duty per unit**	**Total duty on product**
Cider	10.1p	20.2p
Beer	19.1p	38.1p
Made-wine	22.9p	45.8p
Spirit-based	28.7p	57.4p

Source: HM Treasury analysis, Alcohol Duty Review, Call for Evidence, Table 3.A.

Given that alcohol duty may be in line for fundamental reform, it makes particular sense to continue to freeze it now and defer any changes to the level of the tax until a new, fairer structure is put in place. Indeed, raising alcohol duties in line with RPI now would be actively unhelpful to future reform, since it would exacerbate the tax differences between categories, and make any subsequent adjustments designed to rationalise the system that much harder.

Further points in favour of freezing alcohol duty

It is worth noting that a continued freeze in alcohol duty is likely to help facilitate the recovery of the hospitality sector as it recovers from the shock of the pandemic – which obviously hit it extremely hard. The temporary VAT rate on food and non-alcoholic drinks has already risen from 5 to 12.5%; in April it will revert to the standard 20% rate. Reduced migration is also leading to labour shortages in the sector, and may increase costs going forward. In that context, declining to raise alcohol duties would come as a welcome fillip to a hard-pressed industry.

There is also precedent for lower alcohol duties delivering above-expected revenues (and vice versa). As explained in a 2020 CPS report: 'sharp increases in spirits duty in 2012 and 2013 delivered underwhelming revenues. By contrast, the last five years have seen three freezes and

[11] HM Treasury, Alcohol duty review: call for evidence, September 2020.

one cut – and the British spirits industry has thrived, while tax revenues have boomed.'[12] After that report was released, alcohol duty was frozen across the board at the March 2020 Budget. Yet the latest provisional figures (for May–July 2021) show alcohol duty receipts up 6% year-on-year.[13]

RPI and the tax system

For arcane statistical reasons, the RPI measure of inflation tends to be about a percentage point higher than the more widely-used CPI measure. At the moment, that disparity is wider than usual, at 1.6 percentage points (3.2% vs 4.8%).

As a 2019 House of Lords report made clear, having two 'official' inflation measures in circulation allows the government to engage in 'index shopping' – the practice of picking whichever measure best suits its revenue-raising requirements.[14] Hence, upratings that *benefit* the public are practically always carried out in line with the lower CPI figure. These include benefits, tax credits, tax thresholds, NS&I index-linked savings certificates, and so on.

On the other hand, upratings that mean the public *pays more* are usually carried out in line with the higher RPI figure. This includes excise taxes (the ones covered here plus tobacco duty, vehicle excise duty, and air passenger duty) and things like student loan repayments and regulated rail fares. Business rates increases have been linked to CPI rather than RPI since April 2018 – the (honourable) exception that proves the rule.

It would clearly be better, simpler, and fairer if the government used one measure of inflation for everything and ended the cynical practice of index shopping. Accordingly, we believe that any *future* increases in excise duty should be linked to CPI rather than RPI.

Conclusion

There is a strong case for freezing fuel and alcohol duties for a further tax year at the forthcoming Budget. Inflation and already-announced tax and benefit changes are putting pressure on household budgets, especially at the lower end of the income scale. Our existing excise duties are high compared with our neighbours and as a proportion of final sale prices. What's more, both alcohol and fuel duties are outdated in their current form and in need of a serious overhaul – a process that is already underway for alcohol.

The Chancellor froze fuel and alcohol duties at his March 2021 Budget. He should do the same again in a few weeks' time.

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[12] Centre for Policy Studies, 'Tax cuts don't have to be taxing', 27 February 2020.
[13] HM Revenue & Customs, Alcohol Bulletin commentary (May 2021 to July 2021).
[14] House of Lords Economic Affairs Committee, 'Measuring Inflation', 17 January 2019.