PRE-BUDGET REPORT 2003

The Chancellor published his Pre-Budget Report on Wednesday 10 December. The report serves as a mid year statement of public finances and an opportunity to consult on tax and regulatory changes ahead of the Budget in spring 2004.

The Chancellor confirmed his intention to change the basis of the inflation target in the remit of the Bank of England's Monetary Policy Committee. The new measure will be based on the harmonised index of consumer prices, which is the standard measure used across Europe, and will be known as the Consumer Prices Index (CPI). The inflation target will now be set at 2 per cent.

The Chancellor re-stated the underlying strength of the UK economy, which compared favourably with other EU member states, Japan and the USA. Economic growth in 2003 was predicted to be 2.1 per cent, in line with previous forecasts, with growth of between 3 and 3.5 per cent in 2004 and 2005. Net borrowing by Government was due to increase from £23.8 billion in 2002/3 to £38 billion in 2003/4 and remain at around £30 billion in 2004/5 and 2005/6.

Protecting the Environment

The Government re-iterated its commitment to sustainable development and to the use of economic instruments to protect and improve the environment. There were a significant number of measures of particular interest to the automotive sector. These included:

<u>Climate Change Levy</u>: It was announced that the Treasury would be consulting with industry on extending the qualifying criteria for climate levy agreements. It is suggested that a new measure of energy intensity would be used to allow qualifying companies access to the 80 per cent climate change levy discount.

The SMMT has consistently argued for an extension of the qualifying criteria and will be seeking early discussions with officials to maximise the opportunities for companies in the automotive sector.

<u>EU Emissions Trading Scheme</u>: The EU ETS is due to be introduced in 2005. The Government intends to publish details of its national allocation plan shortly. The scheme will operate alongside the existing climate change levy agreements and the Government has announced that it will introduce the equivalent CCL discount for those installations in a climate change agreement that would like to enter the EU emission trading scheme once it is operational.

<u>Alternative Fuels Framework:</u> The Chancellor published the details of an alternative fuels framework to guide the fuel duty regime. It establishes a statement of principles to guide policy, commits Government to a provide a rolling 3 year period of certainty on fuel duty differentials for alternative fuels and stresses the importance of life-cycle carbon emissions in quantifying environmental benefits.

Road Fuel Gases: It was announced that, following its recent consultation, the Treasury had decided that the environmental benefits of LPG did not warrant the current level of fuel duty incentive. It was confirmed that duty on LPG would gradually rise during the next 3 years to a level more consistent with its perceived benefits.

It was also announced that the duty differential on natural gas would be retained for the next 3 years reflecting the Government's view that it continued to provide significant environmental benefits.

Sulphur-Free Fuels: It was confirmed that the Government would introduce a duty differential for sulphur-free fuels of 0.5 pence per litre over ultra-low sulphur fuels from September 2004.

Bio-fuels: It was announced that the Government would examine ways of focusing the fuel duty regime on input as well as product based taxation to incentivise more environmentally and economically efficient types of bio-fuels manufacturing.

Company Car Tax: The Government stated that it will analyse the impact of recent changes to company car taxation before making decisions about further changes.

This is in line with the specific request made by the SMMT in its Pre-Budget submission.

Company Vans: The Government confirmed that it would announce the outcome of its review of the taxation of company vans in the 2004 Budget.

Lorry Road-User Charging: The Government intends to publish a progress report on the development of a lorry road-user charging scheme in the New Year. This will provide more details of the Government's implementation plans and reflect technical developments and recent experience in other countries.

Productivity and Competitiveness

The Government continues to focus its attention on measures to improve productivity and enhance the competitiveness of UK based businesses. The Pre-Budget Report includes a number of measures designed to encourage innovation, investment and skills. The included:

- A new draft definition of R&D to give greater clarity to what constitutes R&D for tax credit purposes. There will also be an extension of qualifying costs to include materials, software, water and fuel used directly in R&D.
- An increase in the small and medium sized company thresholds to allow more investment to qualify for the 40 per cent plant and machinery first year capital allowances.
- The extension of Employer Training Pilots that allow employers to receive compensation for allowing employees time-off for training.

- The Government has published a discussion document on the tax treatment of fees and subscriptions to professional bodies and membership organisations to establish the scope for this system to make a greater contribution to the wider skills and training agenda.
- The Government has initiated a review of UK businesses' experiences of accessing public contracts in Europe to examine opportunities for improving the ability of UK companies to compete more effectively for public procurement contracts.
- The Government published a revised regulatory reform action plan, which identifies a total of 650 de-regulatory measures that will be implemented by Government.

SMMT Comments

The Government's willingness to extend the criteria for access to a climate change levy agreement will be welcomed across manufacturing industry. The automotive sector already has an agreement, but only a limited number of companies currently benefit from it. The task will be to ensure that any new criteria offer the maximum opportunities for the sector to get relief from the climate change levy.

The publication of a more coherent framework for establishing fuel duty incentives has long been a goal for the SMMT. The industry will be equally pleased that the Government has responded positively to the need for certainty in the market place and the commitment to provide a 3 year rolling period of duty differential for alternative fuels represents significant progress. The gradual phasing out of the duty incentive for LPG will create difficulties for the companies that have invested in bringing these technologies and fuels to market.

Changes to the R&D Tax credit are in line with the SMMT's recent submission to the Treasury and should give every opportunity for companies in the automotive sector to seek to increase their investment in developing new and improved products. Whilst it is encouraging that Government is seeking to identify and remove unnecessary regulation, the SMMT is more concerned by the flow of new regulations from both Brussels and Whitehall.