The Society of Motor Manufacturers and Traders Limited
Forbes House, Halkin Street, London SW1X 7DS

Rt Hon Gordon Brown MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

09 March 2005

BUDGET 2006

UK automotive manufacturing and distribution firms remain cautious on improvements in the economic outlook and are wary of further regulatory changes in our markets.

Costs and competitiveness
For 2006 sustained rises in costs and weaker, more variable domestic demand for new vehicles are major challenges to our members. Export markets too are challenging. With three-quarters of UK vehicle output exported, it is vital that our sector has the confidence to develop their operations in the UK. Competitiveness and profitability are strained. The demise of MG Rover in 2005 underlined that our sector is at the very edge of global competition. Restructuring is now a perennial aspect of the business environment. But we are positive that our sector's long term future can be firm if government helps industry meet its competitiveness challenges with a lighter regulatory touch and builds on an integrated approach to regulation in environmental and transport policy.

The recent legacy of domestic economic stability has been very positive for business. We hope that this can be reinforced as firmer growth returns and that rises in key input and energy costs do not get embedded in the system. However, there are other big challenges ahead, with major policy reviews – pensions, housing, energy, skills, transport, better-regulation and public sector efficiency – in progress. These pose big cost and market change uncertainties. Also the UK's EMU entry remains under review as insufficient durability and flexibility still pose significant adjustment costs, but for business trade in euros is a fact. In this setting of economic uncertainty and cost squeeze we want government to help nurture revival in growth and confidence, give the new approaches on vehicle taxation, incentives and labelling time to work and not burden business or motorists with untimely tax or regulatory costs increases.

Some of the key issues that we have raised over the course of the past year and which continue to be high on our members' policy agenda are summarised below.

VED

We value stability in the new VED structures and rates for cars, vans and trucks. The new approach is a novel basis to the annual registration tax and significant revalorisation and/or format change without a clear assessment and justification would be misplaced. We see current rates as giving firm signals to motorists, and for new cars this is now enhanced by the recently introduced and redesigned colour-coded fuel economy label, which is in general use. On the use of incentives our general view is that they be based on common standards, technology neutral and have regard to EC-wide market and regulatory developments.

We recognise the pressure for firmer monetary signals and differentiation amongst new cars, but believe that individual choice on need and use has to be effective. Much firmer action here would ripple though the whole vehicle market – new and used - and could affect the commercial basis to some manufacture in the UK. Any action has to be commensurate with its environmental, commercial and economic effects, and we would see discretionary or ad hoc change as highly misplaced.

For trucks we note that at Budget 2001 government was considering the use of reduced VED for trucks meeting the new Euro 4 standard from 2004. We believe that although this opportunity may have passed, it should be reconsidered as we mover from Euro 3 on to Euro 4 this October and then on to Euro 5. With the emissions abatement technology adding to truck capital cost and operating performance there should be positive environmental and commercial reasons to give a VED incentive to early adopters.

Road fuel duty

The freeze on fuel duty increases continues to be well judged. Rises in all energy costs are a prime concern to business and motorists, so where government can avoid adding to economy-wide cost pressure it should do so. There is a good case again for monitoring, but not inflation-proofing fuel duty. Also there must be some clear rationale for this decision to be more openly linked to trends in the global oil markets and other factors than the present discretionary assessment. The £24bn taken by fuel duties is a key revenue stream, but government can make a real difference to cost trends here.

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The 'Alternative Fuels Framework' helps give some context and planning certainty to the commercial difficulties in the alternative fuel markets to 2007/08. This is useful, but for LPG a challenge as the duty differential narrows. How this affects the market should be carefully monitored. The RTFO is also a critical development in promoting the use of low carbon fuel alternatives. Biofuels certified under the initiative should be related to fuel quality standards, satisfying all 'fit for purpose' parameters. Fuel incentives whether given through the fuel duty rebate or certificates must be referenced on current and future European and UK fuel quality standards. DfT and HMRC need to coordinate their actions here so that consistent and durable signals on fuel quality are in place now to support government's targets for biofuel use in the UK over the years to 2010.

Regulations to assist the early adoption of sulphur-free fuels are now needed with some urgency. With an incentive for this no longer a government priority, there is now a more pressing case to aid early adoption through a clear and timely regulation and promotion of the environmental and performance benefits of these fuels.

Company and business cars
The company car market remains an important market for us. We have seen diesel play a big role in enhancing the CO2 performance of the sector. Conversely, growth of cash allowances and private car use for business with AMAPs allowances is unlikely to have been so successful in improving CO2 performance from this sector. We hope that government's on-going review of the effects of the post-2002 changes can cast further light on this relationship and look forward to working with Government in assessing any lessons that could be learned. We believe that it is appropriate to have equally as strong signals and incentives in the private and company car market.

With diesel having played an important role in the new system's environmental progress to date, it is important to review both the diesel penalty and the case for waiving the surcharge for Euro 5 diesel new cars, when the new standards is being adopted. We see that an early proposal from government and clarity on its duration will give positive signals for early adopters and spur manufacturers to speed models to market. The transition to Euro 4 is now over and experience from this could help in the months ahead, though inevitably there will be some 'unseasonal' break in sales trends at date specific boundaries.

Automotive businesses competitiveness, regulatory reform and business tax
Climate Change Levy rates were frozen for 2005/06. With high energy costs and further sharp price rises in 2006, this remains a relevant adjustment. Our manufacturing members also have on-going concerns on appropriate base planning and detailed compliance and inclusion issues for automotive businesses and plants in Climate Change Agreement and

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also with those in the EU Emissions Trading Scheme. In phase 2 of EU ETS we remain circumspect on any early move to include other sectors – like surface transport and mobile sources – into the frame. We believe that government officials need to have a better understanding of the practical issues our member business face and would caution government not to broaden the plant of business scope of ETS.

On engagement with the better regulation initiative, we fully support a risk based, coordinated approach from government. We value reductions in cost and administrative burdens and want to see the Gershon programme bring benefits to all – to government, business and households. Above all we hope to experience proportionality, consistency, clarity and accountability in all aspects of our relationships with government regulators.

Technical tax issues also have significant commercial effects on our members businesses. On this front there are a number of issues on which we have on-going contact with HMRC officials. We hope that the cap on capital allowances for so-called ‘expensive cars’ can be removed and that any likely use of a CO2 based incentive will be robustly assessed. Many members still doubt the effectiveness of this and were surprised by the terse statement on the use of the 21 band company car CO2 graduation for the private vat fuel scale charge from May 2007. The VAT treatment of combination vans is another area where we believe better regulation can and should be more effective. These are commercial vehicles, but costly tribunals and technical assessment seems to be the only means of confirming their status. There must be an easier solution for business. The Commissioners’ recent change in policy on Export Companies and the VAT stagger under anti-avoidance policy is a further instance of difficulty for our members. These are long-standing schemes with cash flow and reporting advantages. However, our members’ experience with HMRC officials over the past eighteen months has been disjointed. We still disagree on issues of consistency, fairness and proportionality.

Our on-going dialogue on these issues is important, and we look forward to renewing our contacts with your officials and ministers after you present your Budget.

Yours sincerely,

Christopher Macgowan
Chief Executive