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Simone Zambetti: Microeconomics Internal Assessment

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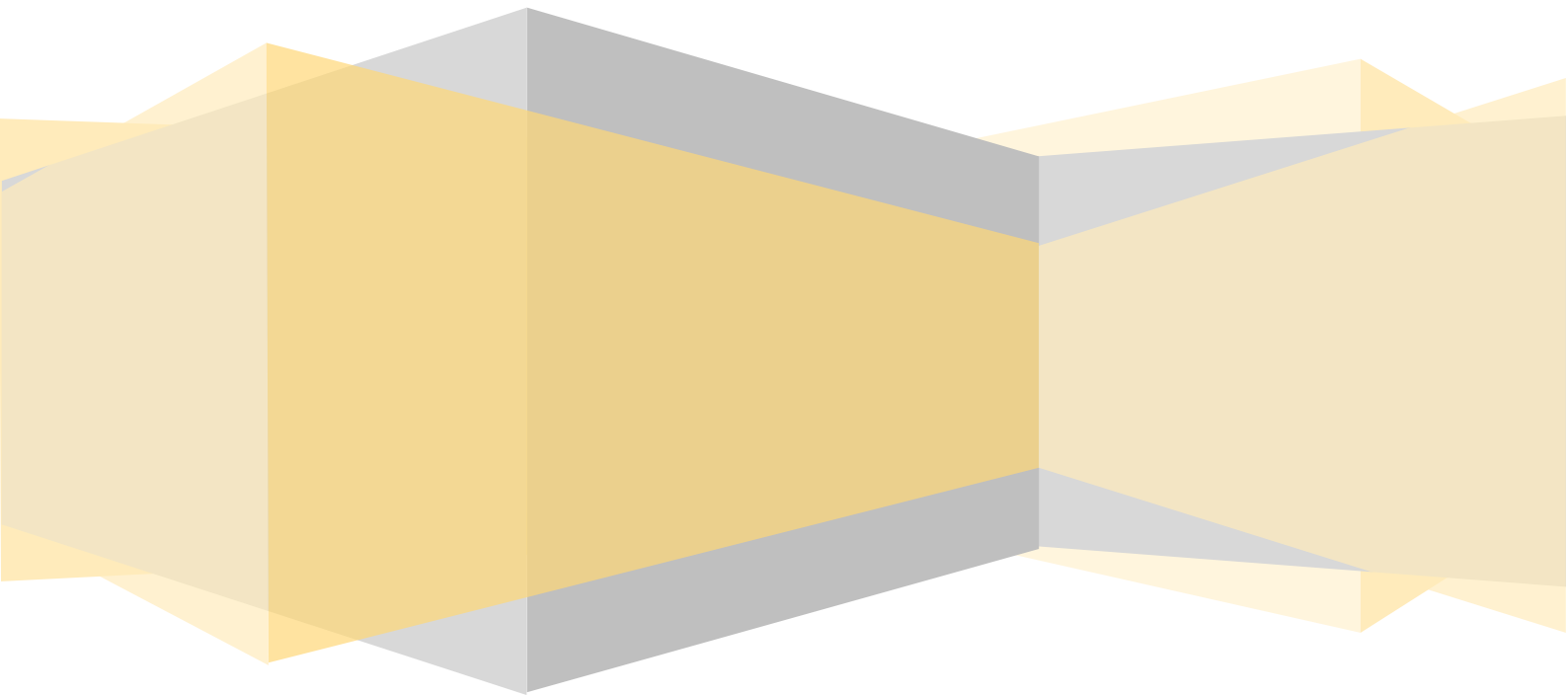
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Budget 2013: Beer down 1p as planned 3p duty rise axed

A planned 3p rise in beer duty has been scrapped and replaced by a 1p cut in the price of a pint.

The chancellor said the alcohol duty escalator - which adds inflation plus 2% to the price - would be abolished for beer completely.

The brewing industry and real ale drinkers' group Camra welcomed the news as "brilliant" and "momentous".

However, news that the escalator will remain for wine and spirits was condemned strongly by these industries.

The reduction in the beer price starts from Sunday "and I expect it to be passed on in full to customers", George Osborne said.

He noted that 10,000 pubs had closed in the last 10 years and that the industry needed support.

The The brewing industry had campaigned strongly for a freeze in duty. "But I'm going to go one step further," Mr Osborne said. "We're taking a penny off a pint... All other duties will remain as previously announced."

The beer escalator was due to run until 2014-15. About £1 of the price of a pint is taken in VAT and duties, and prices are also rising because of the increasing cost of raw materials and energy used in brewing.

Brigid Simmonds, chief executive of the British Beer & Pub Association, said the price cut and abolition of the escalator was "absolutely brilliant news. By cutting the tax on beer, he has moved to boost jobs in Britain's pubs at a time when it is most needed".

"In also abolishing the beer tax escalator, the chancellor has ended a hugely damaging policy that would have made Britain's beer the most heavily taxed in Europe.

"I hope this heralds the start of a long-term change that recognises the benefits of beer and pubs, for the economy, and for society," she said.

"Start Quote

Cutting duty on beer while increasing it on spirits punishes the UK spirits industry for its success. This move risks that success."

-Diageo

Mike Benner, chief executive of the Campaign for Real Ale (Camra), said: "This is a momentous day for Britain's beer drinkers, who will tonight be raising a glass to the chancellor for axing this damaging tax escalator and helping keep pub-going affordable for hard-pressed consumers."

"Since the duty escalator was introduced in 2008, 5,800 pubs have been forced to call last orders for good. What could have been the final nail in the coffin for our pubs has been decisively avoided by the chancellor in a move that will spark celebration in pubs across the UK."

Camra gathered more than 100,000 names on a petition last year calling for a freeze on duty, which led to a parliamentary debate. The group estimated that beer taxes had risen 42% since 2008.

'Unfair, incomprehensible'

However, news that the escalator for wines and spirits will remain sparked a strong reaction from the industry, which questioned whether it was legal under European Union rules to tax alcohol differently.

Wine and Spirit Trade Association chief executive Miles Beale said: "This is bad news for the UK wine and spirits sector, with year-on-year duty increases hitting consumers and businesses hard. It makes little sense to single out beer, particularly as there is a legal precedent to suggest government is unable to do so."

Budget documents

The escalator will add another 10p to a bottle of wine and 53p to a litre bottle of spirits. Mr Beale said that the latest rise means that consumers will have seen wine duty increase by 50% and spirits duty by 44% since the escalator was introduced in 2008.

The body that represents whisky producers in Scotland also attacked the chancellor's decision. The Scotch Whisky Association (SWA) said it was "unfair, incomprehensible and undermines one of Britain's major industries in its home market".

The SWA says the Budget announcement penalizes consumers who choose Scotch Whisky over beer, adding: "Drinkers of a dram are now paying 48% more duty than a beer drinker, further distorting the alcohol drinks market in the UK."

"A reduction in sales of spirits, which are largely bottled in Scotland for the UK market, will hit jobs and employment prospects."

Drinks producer Diageo, whose brands include Johnnie Walker whisky, also condemned the move.

A spokesman said: "This move is disappointing. Cutting duty on beer while increasing it on spirits punishes the UK spirits industry for its success in this harsh economic climate. Scotch is the UK's biggest food and drink export. This move risks that success."

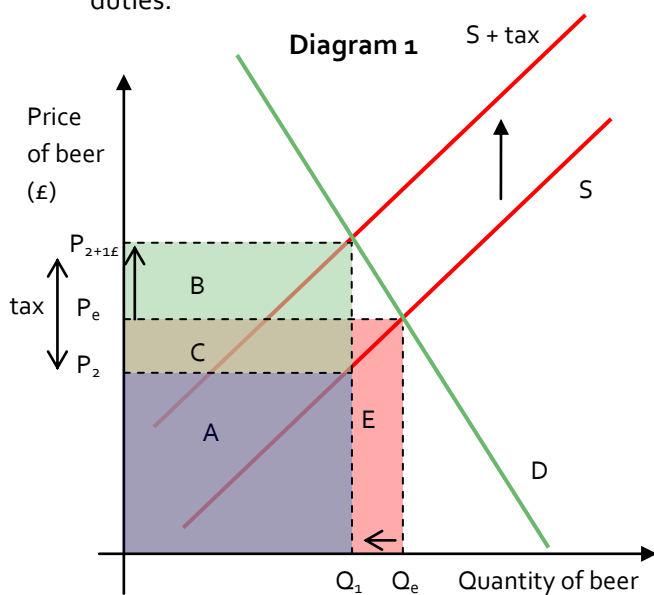
The chancellor's announcement comes amid debate over the minimum price of alcohol. A minimum price was expected to be included as part of the 2012 Alcohol Strategy. A year on, there is speculation that the policy of a 45p minimum price per unit will be dropped.

COMMENTARY

In March 2013, the British government scrapped a possible rise on the VAT for beer, replacing it with a 1p duty axe, in order to benefit all the industry related to beer itself. However, taxes on spirits and wines were kept high with the upcoming possibility of a further increase due to the escalator duty, which shall equal 10p to a bottle of wine and 53p to a litre bottle of spirits.

ANALYSIS OF THE MARKET AND ITS PAST DEVELOPMENT:

In the following paragraph, it will be analyzed the effect of the duty escalator of 2008¹. Therefore, to what concerns the beer market, a per-unit tax was applied. The following diagram represents this increase in duties.

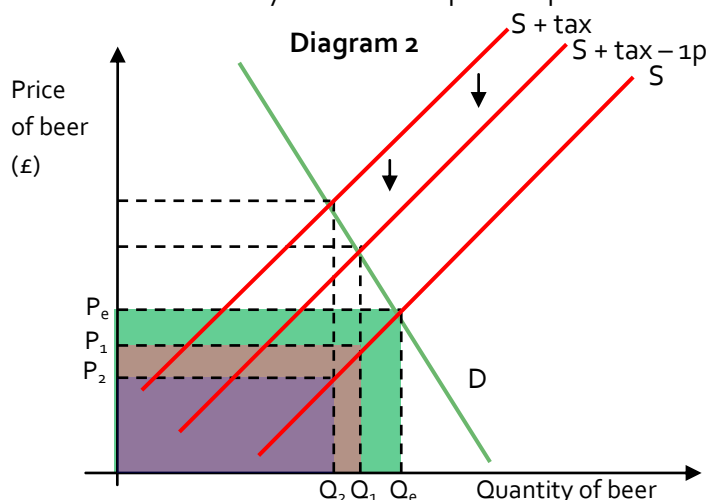


Initially, the market equilibrium was at price P_e and at quantity Q_e ; after the duty escalator, the market equilibrium has shifted to $P_{2+1£}$ and Q_1 , as a result of the tax, whose value is equal to the gap from P_2 to $P_{2+1£}$. From the graph, it can be observed that the price of beer for consumers rose from P_e to $P_{2+1£}$, which is their share of the duty. Thus, the area B represents the consumer burden, as they now have to spend more to purchase a lower quantity of beer.

Instead, producers now receive C per unit output, due to the tax $P_{2+1£} - P_2$ paid to the government. Their revenue therefore decreases to the area A, from the original area constituted by area CAE. Since E is lost due to the decrease in the equilibrium quantity of beer, C must be the producers burden.

Thus it results that this tax revenue to government is the addition of area C and B, or rather the addition of consumer and producer burden. Since producers' revenue has decreased, they are much more likely to lay off workers, thus creating unemployment.

If the graph above showed the situation of 2008, then, in the following diagram, it is demonstrated how a cut in the duty escalator of 1p will impact the market of beer itself.

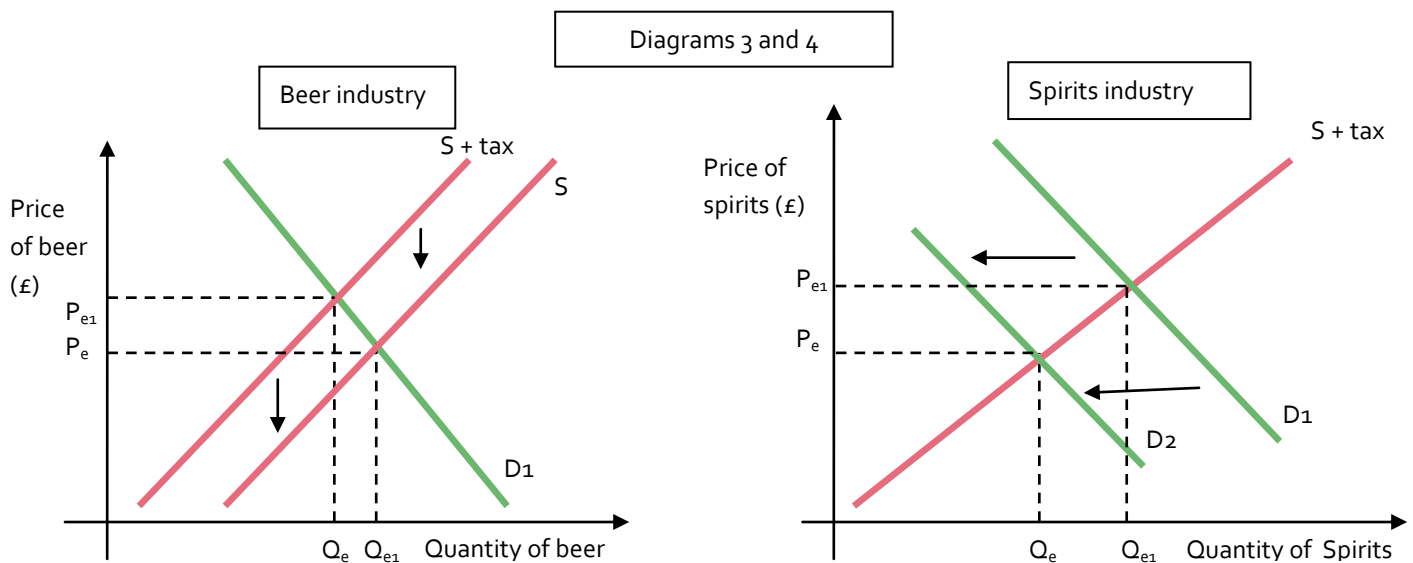


This graph shows how the producer revenue increases as taxes decreases. In fact, coloured areas indicate producer revenue. At the supply curve S, there are no taxes applied; its producer revenue is equal to the green rectangle $P_e Q_e$, which is larger than all the others, where taxes are applied. As it can also be spotted, producer revenue of the supply curve, where taxes have been decreased ($S + \text{tax} - 1p$), which on the graph corresponds to the violet area plus the pink area, is bigger than the one with taxes ($S + \text{taxes}$), namely just the violet area.

¹ When "About £1 of the price of a pint is taken in VAT and duties", citation from page 1 of the article.

Consequently, the British government's tax axe is aimed to increase producers' revenue: its impact to stimulate the market would bring strong economical support, after having tackled the deep crisis of last few years created by tax escalators and the global recession. In fact, since the duty escalator was introduced in 2008, "5,800 pubs have been forced to call last orders for good", shut down which had a terrible impact on the beer industry, as quantity demanded drastically fell, as a result of less consumers (in this case the pubs).

However, the association of alcoholics has expressed concerns regarding government's promotion of beer consumption. In fact, the tax cut only includes beer, whilst on spirits the escalator tax would still subsist, raising their price by "more than 48%" with respect to beer. Considering that spirits are substitutes of beer, and therefore have a high positive XED between themselves, the decrease in the price of beer itself would result in a drastic drop in demand of spirits, hitting heavily spirits producers' revenue, whose likely impact shall be a worsening in "employment prospects". This is shown in diagrams 3 and 4:



Diagrams 3 and 4 - The two diagrams show how the industry for spirits reacts to a shift of the supply of beer, which causes a lower equilibrium price for beer. Therefore, the spirits industry's demand falls as more consumers will purchase beer, attracted by lower prices. Spirits producers' revenue crumbles from $P_{e1}Q_{e1}$ to P_1Q_1 .

In conclusion, although the tax axe will facilitate the stimulation of the beer market with benefits to both consumers and producers, it may mine the stability of the industry for spirits and wines, as mentioned earlier. Therefore, it appears obvious that there are two possible scenarios to prevent this self-damaging consequence: first, duties should be also lowered for spirits as well, or beer should not experience a decrease in taxes at all. In addition to this, it might be argued that beer is a demerit good and an increase in supply will cause negative externalities on third parties, with a consequent rise in welfare loss. For all these reasons, I would discourage a tax cut on beer, but rather support it on other goods or services, whose impact on the economy will be more beneficial.