

The Aggregates Levy:

Between a Rock and a Hard Place

1.1 This memorandum sets out the key concerns of the British Aggregates Association (BAA) and its members, ahead of the Pre Budget Review 2003. It draws on discussions with independent quarry operators throughout the UK, as well as a wide range of research on the aggregates industry and the operation of the aggregates levy. **During the eighteen months of the levy's operation, compelling evidence has emerged of resulting economic and environmental damage and the industry in Northern Ireland faces a worsening crisis. The Pre Budget Review therefore offers an important opportunity to thoroughly review the economic and environmental impacts of the levy in advance of Budget 2004. Our memorandum also highlights certain practical problems that should be urgently addressed.**

1.2 The BAA was formed to represent and protect the interests of the UK's independent aggregates producers, and now represents over sixty independent and privately owned quarry companies. Aggregates are vital to provide the needs of society – schools, hospitals, roads, railways and housing. The industry provides employment for up to 70,000 people, mainly in rural communities, and contributes around £3 billion in primary products to GDP. A healthy independent sector is vital to the future of quarrying, but unfortunately independent quarry companies are in decline. Aggregates companies have invested large sums in complying with stringent environmental regulations, and have created numerous Sites of Special Scientific Interest (SSSIs) and RSPB sites through both the establishment and restoration of quarries. A healthy independent sector is vital to the future of UK quarrying.

1.3 Compelling evidence continues to emerge that the aggregates levy is causing a crisis in Northern Ireland's quarrying industry, and serious difficulties across the industry in Britain. The BAA does not believe that the aggregates levy delivers environmental benefits in addition to the current strict regulatory regime and pre-existing incentives to recycle; indeed considerable evidence of environmental damage due to the levy is emerging.

1.4 The memorandum is split into two parts:

- Evidence and analysis of the practical problems faced by quarry operators in implementing the levy, together with the BAA's proposed policy solutions to these problems
- A brief assessment of the levy against the Government's claims for it

1.5 The levy continues to cause increasing problems for the aggregates industry. The current crisis in Northern Ireland's aggregates industry was escalated when the levy was implemented for aggregates used in processed

products, and will become even worse if the amount of the levy is increased as planned. Across the UK, new spoil heaps of unsold aggregates by-products are becoming a serious environmental blight, a problem which will continue unless and until the market distortions caused by the levy are addressed. Since Budget 2003, evidence has emerged that new unauthorised and unlicensed operations to extract aggregates have been established in many parts of the UK, due to the ease of evading the levy and obvious incentive to do so. Additional problems that have yet to be resolved include distortions caused by the distinction between "added" and "naturally occurring" moisture, and serious cash-flow problems affecting smaller operators.

1.6 The BAA proposes the following key policy initiatives to help tackle the problems caused by the levy:

- **Abandonment of the levy in Northern Ireland.** Failing this,
 - a reduction in the amount of the levy in Northern Ireland, and certainly no further increase in the levy for aggregates used in processed products in Northern Ireland; and
 - urgent review of enforcement in Northern Ireland; and
 - urgent review of the economic and environmental impacts of the levy there
- Exemption of aggregates by-products from the levy, to provide a level playing field with competing by-products from other extractive industries
- Government appointment of specialist minerals consultants to help solve the problems with aggregates by-products, and in particular to provide workable definitions of "waste" and "by-products" to enable the implementation of the policy outlined above
- Enforcement action by Customs and Excise to target the numerous new unregistered and unregulated aggregates producers in most parts of the UK
- Adoption of phased accounting systems for payment of the levy by small and medium sized firms
- Removal of the confusing and damaging distinction between "naturally occurring" and "added" water by excluding all moisture content from the scope of the levy
- A full and detailed review of the levy, including a clear statement of how the Treasury will review the economic and environmental impacts of the levy, and involving the industry

1.7 The BAA proposes constructive changes to the aggregates levy above, as the problems affecting the association's members need to be tackled urgently, now that the levy has been in operation for eighteen months.

1.8 However the BAA remains convinced that, as more and more evidence continues to emerge that the aggregates levy cannot deliver overall environmental improvements, and is causing needless commercial damage, there is ultimately no sensible alternative to

scrapping the levy. There should most certainly be no increase in its level.

2. Problems Encountered with the Levy

The aggregates levy impacts on the quarrying sector in a number of ways. With eighteen months now elapsed since the levy was implemented, strong evidence continues to emerge of a number of damaging side-effects caused by the levy.

2.1 Problems in Northern Ireland

2.1.1 The aggregates industry in Northern Ireland is experiencing a crisis. With a massive decline in sales volumes, quarry closures and job losses have begun and will accelerate if the levy is increased for aggregates used in processed products, as planned. This situation must be addressed urgently.

2.1.2 Aggregates production dropped by three million tonnes (representing 10% of the market) in 2002, compared with 2001. The true picture is even worse, since extensive pre-selling and stockpiling occurred in the first quarter of 2002, prior to the introduction of the levy. Some counties, and some companies, have experienced a decline in aggregates sales of 40% since April 2002. This situation is worsening as the levy is now applied to aggregates used in processed products. The figures for aggregates sales in 2003 are therefore likely to show a far worse picture.

2.1.3 It is notable that construction activity (and therefore demand for aggregates) increased during this period. A decline of this magnitude therefore must indicate large increases both of smuggling and of quarrying at small, unregistered sites.

2.1.4 Research carried out by the University of Ulster found that aggregate has been imported across the border from the Republic at a rate of two million tonnes per annum since the levy began, equivalent to more than 11% of border counties' aggregate production. Prior to the introduction of the levy, the level of imports was negligible, since prices were virtually the same in Northern Ireland and the Republic.

2.1.5 Smuggled aggregates are seriously undermining legitimate aggregates businesses in Northern Ireland, particularly in the border counties, where a large proportion of quarrying is concentrated. The nature of the border, with numerous minor, rural crossing points, makes evasion relatively easy – as has been demonstrated with fuel smuggling. This point has long been acknowledged by Customs and Excise.

2.1.6 The levy is also acting as the incentive for a massive increase in quarrying at small, unauthorised sites, and in "black market" aggregates. At least 38 illegal quarries have appeared in Northern Ireland since the introduction of the levy. Unauthorised quarries are not controlled through the planning system. They do not observe the stringent environmental regulations

applied to the industry. Neither are they likely to observe employment legislation, health and safety procedures, or hold adequate insurance. The 22% fall in sales in Antrim, at some distance from the border, can only be explained by a dramatic increase in "black market" aggregates. The Exchequer is losing significant amounts of revenue from both the aggregates levy and VAT due to Customs and Excise' inability to prevent unregistered quarrying.

2.1.7 Customs and Excise are unable to properly enforce the levy. They lack the resources to tackle this problem, and are inevitably focused on the smuggling of high priority goods such as fuel, alcohol and tobacco. The penalties faced for tax evasion, in the unlikely event of being found out, are small compared to the gains to be made. Industry representatives have discussed enforcement issues on numerous occasions with Customs and Excise, but have neither received a satisfactory response, nor seen any improvement on the ground. To the BAA's knowledge, there have been no prosecutions for aggregates smuggling or unauthorised quarrying in Northern Ireland since the introduction of the levy. In the long term, many quarry operators in Northern Ireland are likely to face a choice between either going out of business, or breaking the law.

2.1.8 Legitimate quarries are finding their business consistently undermined, and have reported losses of up to 75% of their business because of the levy. The quarrying industry provided 211 fewer jobs in 2002 compared to 2001. Fifty-four compulsory redundancies in the twelve months April 2002 – April 2003 have been identified from among the members of the Quarry Products Association Northern Ireland as directly attributable to the levy, and job losses have continued since then. The situation is undoubtedly even more serious than the number of redundancies would suggest, since the majority of Northern Ireland's quarrying businesses are family-run, and will not make official "redundancies". It is particularly regrettable that many of the areas worst affected are severely disadvantaged, and have been designated "Targeting Social Need" areas by the Government; jobs lost there are extremely difficult to recover and the impact is being felt acutely.

2.1.9 Businesses processing aggregates (for example producing concrete or asphalt) are being forced to move across the border. This is because aggregates levy is due on aggregate processed within Northern Ireland, wherever it is sold, but is not due on aggregate processed outside Northern Ireland, even if the processed products are then sold within the province. Aggregates processing has historically been a strength of Northern Ireland's industry; the economic and employment benefits of this will now be lost. In addition, the increased road haulage that will result from the relocation of processing plants across the border will result in new environmental impacts. Moving concrete production facilities into the Republic of Ireland also offers significant savings in tax and fuel costs. This movement is likely to be irreversible.

2.1.10 Extensive evidence of a deepening crisis in Northern Ireland's quarrying industry, precipitated by the aggregates levy, continues to emerge.

The industry cannot simply "adapt" to the levy, as the Treasury hoped. In part, this is because the £1.60 fixed rate of the levy added 56% to the £2.85 per tonne average price of aggregate in Northern Ireland, a far higher proportion than in other regions of the UK. The problems faced in Northern Ireland must be addressed urgently.

Proposed Solutions:

2.1.11 There is an overwhelming case for the complete revocation of the aggregates levy within Northern Ireland. This should occur at the earliest possible opportunity, before further needless damage is caused (imports from Northern Ireland to Britain must however be taxed under this proposal, to protect British competitiveness). Only abandonment of the levy in Northern Ireland can prevent the decimation of the industry, numerous job losses and attendant economic and social damage.

2.1.12 If a complete revocation of the levy in Northern Ireland is impossible, a reduction in its level should be considered. This would reduce the severity of the impacts of the levy, although it would not fully solve the serious economic and commercial problems associated with it. As a bare minimum to avoid escalating the crisis, there should be no increase in the level of the aggregates levy for aggregates used in processed products in Northern Ireland.

2.1.13 If the aggregates levy is not revoked in Northern Ireland, there must be a full review of enforcement action in Northern Ireland.

2.1.14 As evidence continues to emerge that the levy is causing severe damage to Northern Ireland's quarrying industry, and that the claimed environmental benefits of the levy in Northern Ireland are unlikely to be realised, the BAA remains extremely concerned that no proper investigative study of the situation in Northern Ireland has yet been published, and the Symonds Report, covering some of these issues, has been delayed.

2.2 Problem of Unsold By-Products

2.2.1 The levy has distorted localised markets for by-product aggregates, which are increasingly being substituted by the by-products of other industries, such as slate. This is proving severely damaging to some firms, and raises obvious questions about the environmental benefit of substituting spoil heaps in one extractive industry for spoil heaps in another

2.2.2 Aggregates by-products are unavoidably produced when extracting and processing virgin aggregate to produce a quarry's primary product. This has never been treated as "waste", since it could be sold cheaply, for use in products such as concrete blocks, or for use as a cheap "fill" material, for around £1 per tonne. The £1.60 per tonne levy has made aggregates by-products commercially unattractive and unsaleable in many areas.

2.2.3 In the many places where by-products from other industries are available for use as aggregate the effect of the levy has been to devastate localised markets for the by-products of taxable aggregate. This has had a severe impact on some companies. For example, sales of aggregates by-products at Penmaenmawr Quarry near Conwy are in competition with locally produced slate by-products. Their sales have fallen by 60% since the introduction of the levy, a development that has led to the redundancies of 25% of the workforce. A similar situation is experienced by many quarry operators in Southwest England, where china clay by-products are readily available and have, since the introduction of the levy, made aggregates by-products commercially worthless. (Clay can be, and is, used as aggregate, for example in lining reservoirs or constructing motorway embankments.) In one case, a large aggregates producer based in Kent reports that slag is even being imported from the continent and used locally in place of low-grade aggregates, seriously damaging sales. The absence of a level playing field for all materials used as low-grade aggregates creates a perverse incentive for untaxed industries, such as slate and china clay, to continue producing extremely high levels of by-product and not to develop alternative uses for their by-product.

2.2.4 BAA members report that large new spoil heaps of unsold by-products have been piling up since April 2002, with clear detrimental effects on the local environment. A recent survey of BAA members found that 65% reported a problem with unsold by-products; the producers affected were only able to dispose of 33% of the material, half the level immediately prior to the levy's introduction. The size of this problem will become more obvious over the longer term as the management in larger companies become aware of the problems on the ground. The BAA estimates that, even during the first year of the levy's operation, between ten and fifteen million extra tonnes of "waste" were created.

2.2.5 Turning by-products into waste clearly contradicts the spirit of the Government's own Waste Strategy 2000. Waste problems in other industries (that invariably extract their products in almost exactly the same way as aggregates) are being solved, at the expense of creating a waste problem for the aggregates industry. Clearly there is no overall environmental benefit derived from this.

Proposed Solutions:

2.2.6 The Treasury's commitment to encouraging the positive use of aggregates waste, was welcome, but has not yet addressed the real problem. The Treasury's previous attempt to address the issue focused on a narrowly defined category of "aggregates waste". However the inability of many producers to sell their by-products when subject to the levy means that such by-products are becoming "waste" by default, even though they are materials that could previously have been used beneficially and would not usually be defined as "waste". In tackling the problem of "waste", the Treasury needs to take account of this growing problem of unsold by-products, before serious environmental and economic harm results.

2.2.7 The distorting effects of the levy on localised markets for low-grade aggregates should be alleviated by creating a level playing field. Ideally, this should be achieved by exempting aggregates by-products from the levy. This would avoid simply transferring the problem of spoil heaps from other industries to the aggregates industry.

2.2.8 The Treasury should appoint specialist minerals consultants to find solutions to the problems of defining "aggregates by-products" and "waste", for the purposes of policy-making.

2.2.9 The BAA is concerned that progress on this issue seems once again to have come to a halt, and would welcome a statement of progress and intent.

2.3 Problem of "Black Market" Aggregates

2.3.1 The level of the aggregates levy, together with the immense difficulties in its enforcement, have created an enormous incentive for unauthorised, unregistered aggregates extraction. Unauthorised quarries pay no VAT or aggregates levy, resulting in a significant loss to the Exchequer, and are also highly unlikely to conform to the stringent environmental regulations complied with by the rest of the industry, or to attend to regulations on health and safety, employment rights and insurance. Examples of unauthorised, unregistered aggregates extraction can be found in many parts of rural Scotland in particular.

2.3.2 Customs and Excise lack the resources and the incentive to tackle the problem. Individual cases of unauthorised extraction are generally small – for example small building sites, or farmers with open "borrow pits" – and are therefore extremely difficult to tackle. Such sources of untaxed aggregate have a massive impact on nearby legitimate aggregates businesses, particularly small businesses, but represent comparatively small sums of money within Customs and Excise' overall workload.

Proposed Solutions

2.3.3 More vigorous enforcement action by Customs and Excise against unauthorised, unregistered aggregates extraction is needed to prevent serious damage to legitimate aggregates businesses.

2.3.4 However, it may ultimately prove impossible for Customs and Excise to sensibly enforce the aggregates levy. The plight of legitimate quarry operators forced to contend with unauthorised aggregates extraction triggered by the aggregates levy provides a further compelling reason for the levy's abolition.

2.4 Cash-flow Problems

2.4.1 Some two thirds of BAA members report adverse cash-flow resulting from the imposition by Customs and Excise of a 30-day credit, in an industry where normal settlement terms are 60 to 90 days. This imposes major costs

on small businesses. Smaller quarry operators in Northern Ireland have been hit particularly hard, as the aggregates levy exceeds 50% of their turnover.

2.4.2 The BAA is concerned that insufficient account has been taken of the compliance costs associated with the levy, which disproportionately affect small and medium sized producers. This directly contradicts Treasury policy to keep the deadweight compliance costs of environmental taxes to a minimum.

Proposed Solutions

2.4.3 Phased accounting systems are already available for VAT, for small and medium sized businesses. The extension of a similar scheme to enable small and medium sized aggregates producers to spread their payment of the levy would alleviate current cash-flow problems. Eligibility for such a scheme should be extended to all firms below a threshold of £5million turnover.

2.5 Problems with Moisture Content

2.5.1 Section 17 (1) of the 2001 Finance Act draws an illogical and impractical distinction between taxable "naturally occurring" moisture, and untaxed "added" water. This has a massive impact on a segment of aggregates producers, mainly small companies, who work wet deposits, particularly when they sell aggregates "as raised". In practice, buyers of aggregate are educated experts, who recognise that aggregate can contain variable amounts of moisture, depending on conditions and the type of aggregate. Prices are negotiated with this reality in mind and are often agreed on the basis of a maximum moisture content. In this sense, the market does not pay for the moisture content of aggregate. However the current legislation does not recognise this, creating some significant distortions within local aggregates markets. It is causing particularly severe problems for the minority of operators extracting aggregate from below the water table, where they are in direct competition with local sources of "dry" aggregate.

Proposed solutions

2.5.2 The BAA believes including moisture in the scope of the levy is fundamentally illogical, since water cannot function as an aggregate and is not, in reality, paid for by buyers. The only way to sensibly resolve the treatment of the moisture content of aggregate is to change the primary legislation, so that the moisture content of aggregate is excluded from the scope of the levy.

3. Delivering Real Environmental Benefits Cost-Effectively?

3.1 The aggregates levy was introduced with the aim of reducing the environmental impact of aggregates quarrying. But has it achieved the benefits claimed? This section briefly assesses the effect of the levy against both the environmental claims government has made for it and the Treasury's statement of intent on environmental taxation.

3.1.1 *"The levy will encourage the use of construction and demolition waste which is currently landfilled"*

Just 633,000 tonnes of hard waste per year, clean or contaminated, was landfilled in England and Wales prior to the introduction of the levy, equivalent to less than 0.6% of UK aggregate production. Construction and demolition waste costs around £1.50 per tonne to recycle, and can be sold for around £5 per tonne. Recycling such waste saves £10 per tonne (£2 in landfill tax plus at least a further £8 in tip charges, haulage and administration charges). Targets to recycle such materials are increasingly being used; for example under Agenda 21 local authorities have increased still further their recycling of hard waste. These cost incentives, together with the development of highly mobile, relatively cheap machinery to process hard wastes, led to a dramatic increase in the level of recycling before the aggregates levy was implemented. The aggregates levy is, by comparison to these measures, a relatively ineffective, not to say blunt, tool.

3.1.2 *"The levy will promote the use of alternative materials such as waste tyres"*

More powerful means of promoting the use of alternative materials already existed before the introduction of the aggregates levy. Landfill tax created an economic incentive to re-use and recycle construction and demolition waste, and tighter regulations on the disposal of waste had already necessitated finding alternative uses for many materials. For example, the EC Directive banning the landfill of whole tyres by 2003, and shredded tyres by 2006, means that waste tyres will be re-used and recycled whether or not there is an aggregates levy. The main restraint on the use of such alternative materials is the strict specification of materials for many uses, rather than their cost.

3.1.3 The vast majority of alternative materials can only be substituted for low-grade aggregates, usually produced as by-products. The distortion of the market for such by-products is effectively turning them into waste in many areas, as demonstrated in section two above. Waste problems in other extractive industries are being solved, at the expense of creating a waste problem for the aggregates industry. No overall environmental benefit is derived from this.

3.1.4 *"Reductions in noise and vibration, dust and other emissions to air, visual intrusion, loss of amenity and damage to wildlife habitats."*

Prior to the introduction of the levy, the quarrying industry had already invested large sums in conforming to extremely high environmental standards, such as the requirement to use the "best available technology" to reduce environmental impacts. Together with the responsible approach of the industry, such requirements have reduced the environmental impact of quarrying to the greatest extent possible. Can the same be said of untaxed extractive industries, such as slate and china clay?

3.1.5 It should also be noted that once extraction has ceased at a site, it can be put to numerous socially and environmentally beneficial uses, including the creation of recreational amenity and sports facilities, the creation of wildlife habitats and geological exposures, the recovery of archaeological remains, and essential services such as waste disposal or water storage. A large number of sites of special scientific interest (SSSIs) have resulted from the restoration of old quarries.

3.1.6 The Aggregates Levy Sustainability Fund, set up to address the environmental impacts attributed by the Government to aggregates quarrying, is finding it increasingly difficult to fulfil this remit. The Community Environmental Renewal Scheme (CERS), which administers Sustainability Fund grants in Scotland on behalf of the Scottish Executive, has so far spent just £584,000 out of its £1.35 million share of the Sustainability Fund, which must be spent by March next year. CERS is experiencing difficulty in identifying suitable projects – ie projects that improve the environment and help local communities affected by quarrying - to spend the rest.

3.1.7 The environmental justification for the levy is flawed. The research commissioned by the former Department of the Environment, Transport and the Regions (DETR), upon which both the decision to introduce the aggregates levy and the level of the tax were based, used the controversial contingent valuation technique to measure the environmental impacts alleged in paragraph 3.1.4 above. It is notable that only one in ten respondents were prepared to pay anything to shut their local quarry, which means the levy is based on the views of a vocal minority. The research is now outdated, because since it was conducted in 1999 environmental regulation has been tightened, and the performance of quarries has improved still further. These changes include the EU requirement for all new aggregates sites to undergo Environmental Impact Assessments, and additional protection for SSSIs, a significant number of which the aggregates industry is guardian to.

3.1.8 *"The levy will promote greater efficiency in the use of virgin aggregate"*

By pricing aggregates by-products out of many of their local markets, the aggregates levy is preventing them from being used efficiently and is thereby creating new spoil heaps of virgin aggregate. The exemption of spoil from industries such as slate and china clay, with up to 96% by-product, rewards less efficient industries by punishing the aggregates industry, which has always tried to find uses for all its by-products.

3.1.9 *"environmental taxation must meet the general tests of good taxation"*

The Government claims that the aggregates levy is in line with the Treasury's Statement of Intent on Environmental Taxation, which said, *"environmental taxation must meet the general tests of good taxation. It must be well designed, to meet its objectives without undesirable side-effects; it must keep deadweight compliance costs to a minimum; the distributional impact must be*

acceptable; and the implications for international sectoral competitiveness must be taken into account" .

- The levy is enormously complex, and has been cited by the CBI as an example of poor design and legislation.
- Undesirable side effects have already emerged, notably new heaps of aggregate by-product which cannot be sold when subject to a levy of this magnitude, and unauthorised aggregates extraction at numerous sites throughout the UK.
- Additional compliance costs such as cash-flow problems have been very significant for some operators, imposing an unfair burden on small aggregates producers.
- Northern Ireland's aggregates industry continues to sustain catastrophic damage from the competition it faces from imports (both legitimate and illegitimate) from the Republic of Ireland, and a massive increase in "black market" aggregates.

3.1.10 On the evidence above, the aggregates levy cannot "deliver real environmental gains cost effectively", and therefore contravenes Treasury policy.

4. Conclusion

4.1 Eighteen months after the implementation of the aggregates levy, the compelling evidence presented above demonstrates that, despite aiming to improve the environment, it is causing both environmental and economic damage. The Treasury must not miss this further opportunity to address the various problems caused by the levy.

4.2 The ongoing crisis in Northern Ireland's quarrying industry needs to be addressed immediately. The aggregates industry has proved unable to adapt to the levy, which should therefore be abandoned there.

4.3 Throughout the UK, the new heaps of unsold aggregate by-products will develop into a serious environmental problem in the long term, unless a level playing field for the by-products of extractive industries is recreated. Further environmental and economic damage is resulting from unauthorised aggregates extraction across the UK, caused by the introduction of the levy. This problem must also be addressed. The BAA's proposed measures to prevent severe damage to small businesses from cash-flow problems and the tax treatment of the water content of aggregate should be given serious consideration.

4.4 Given the important criticisms levelled at the tax, the Treasury should now make a commitment to undertake a comprehensive and detailed review of the aggregates levy after one year of its operation. Such a review should include an assessment of whether real environmental benefits have been achieved. This assessment should include quantification of any increase or reduction in noise, vibration, dust, visual intrusion, loss of amenity and damage to wildlife habitats since 1 April 2002, and of any reduction in the percentage of

construction and demolition waste sent to landfill. It should also assess the overall cost of the levy, including VAT and compliance costs. Customs and Excise' ability to enforce the levy should be assessed by determining the extent of unlicensed quarrying across the UK and of aggregates smuggling in Northern Ireland. The impact of the levy on smaller companies should be separately assessed within such a study, as smaller quarry operators have faced particular difficulties. This full assessment is vital, to determine whether the aggregates levy really is delivering environmental gains cost-effectively.

4.5 Evidence continues to emerge that the aggregates levy is not delivering overall environmental improvements, and is causing needless commercial damage. Whilst the BAA makes a number of policy suggestions to tackle the immediate problems faced by aggregates producers, now that the levy is in operation, the association also continues to believe that the evidence demonstrates there is ultimately no sensible alternative to scrapping the levy. There should certainly be no increase in its level.

British Aggregates Association

October 2003