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The Windfall Tax

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Abstract

This paper analyses the windfall tax on the privatised utilities, introduced in the 1997 Budget. It describes the main arguments put forward for the tax and sets out the details of its scope, scale and method of implementation. The tax is examined against the guidelines of economic efficiency, fairness and administrative feasibility. A one-off tax based on past profits should be efficient, provided that the statement that it is one-off is credible. However, as a tax levied on companies, it does not directly tax the windfall gains that were made in the past by shareholders in the companies concerned.

JEL classification: H25, L51, L98.

I. INTRODUCTION

'Our reform of the welfare state — and the programme to move the unemployed from welfare to work — is funded by a new and one-off tax on the excess profits of the privatised utilities.'

Gordon Brown, Budget speech, 2 July 1997

The centrepiece of the Labour Party's first Budget in 18 years was the introduction of a welfare-to-work scheme, designed to help the young and long-term unemployed back into work. The programme, projected to cost about £3.5 billion, will be financed by a one-off tax on the privatised utilities. The Budget revealed that the tax would raise a total of £5.2 billion in two stages, from a group of over 30 privatised utility companies, and would be based on a measure of the increase in the value of the companies during their first four years in the private

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sector over their value at privatisation. This paper discusses some of the background to the tax, sets out the details and examines whether it fulfils some traditional guidelines for tax policy.

II. BACKGROUND

As early as 1992, the Labour Party proposed that a one-off tax should be levied on the privatised utility companies. This proposal became one of the Party's main pledges in its election manifesto of 1997, and was implemented in the newly elected government's first Finance Act. A windfall gain was said to have accrued to the owners of the utility companies due to a combination of an underpricing of shares in the companies when they were first offered for sale and the under-regulation of the companies in their initial years in the private sector. The goal of a windfall tax was to retrospectively claw back some of those benefits received by the owners of the companies concerned and, in so doing, raise the revenue needed to finance a welfare-to-work scheme.

What is the evidence that the companies were sold off too cheaply? With the benefit of hindsight, it is clear that many newly privatised companies experienced an increase in their share price in the first day of trading. In some cases, shares opened over 50 per cent higher than the offer price, bringing an immediate capital gain for those who sold out quickly.[1] This short-term increase in price indicates that the shares were priced below the level that investors were prepared to pay for them at the time. Over the longer term, some utilities continued to perform well, while others did not do so well. Table 1 shows the percentage growth in utility company share prices over and above the share price growth for a broad index of companies (the FTSE All-Share Index). The growth rates are measured from privatisation until three alternative dates: the first 100 days, the first year and the first four years after flotation.

The share price index for the regional electricity companies (RECs) increased in value by 26 per cent over and above the market as a whole in the first 100 days, and that for British Telecommunications (BT) by 51 per cent. By contrast, the Scottish electricity generators barely outperformed the market. Four years after privatisation, the differences are more striking. The longer-term share price increases could reflect changing perceptions of the strength of the regulatory environment, which came into operation following the privatisations.

Were the regulatory regimes too lax? The companies covered by the windfall tax were privatised subject to the statutory control of an industry regulator, whose primary role is to ensure that all reasonable demands for the particular service being provided can be met. In addition, the regulator has a duty to promote competition in the industry and, where this takes time to develop or where a

[1]See Curwen and Holmes (1992) for a discussion of the gains to stags from privatisation, i.e. those who sold their shares on the first day of dealing.

TABLE 1

Relative Share Price Growth since Flotation

Sector	*Privatisation date*	*Share price growth relative to FTSE All-Share Index (%)*		
		First 100 days	First year	First 4 years
BT	11/84	51	52	18
British Gas	12/86	10	22	32
BAA	7/87	43	39	69
WASCs	12/89	31	58	93
RECs	12/90	26	23	124
English generators	3/91	28	27	109
Scottish generators	6/91	2	4	4
Northern Ireland Electricity	6/93	32	46	21
Railtrack	5/96	3	15	—
British Energy	7/96	17	21	—

Note: The privatisation dates give the month and year that shares in the privatised companies were first listed on the Stock Exchange. The growth rates given are all measured relative to the original offer price, up to the three different dates given, i.e. they are cumulative rather than annual growth rates. The share price data have been rebased to 100 at privatisation and scaled by the FTSE All-Share Index rebased for each respective privatisation date. The price indices given for the regional electricity companies (RECs), the water and sewerage companies (WASCs) and the electricity generators were calculated using individual company share price data weighted by their current market values.
Source: Datastream International and own calculations.

statutory monopoly is to remain in place, to protect customers through the setting of controls on prices and quality of service.[2] The regulator also has to promote social and national objectives, such as ensuring companies provide some uneconomic services that meet the government's wider policy objectives — for example, providing emergency services and special services to the elderly or disabled. If the regulatory regime fails, perhaps through insufficiently tight price controls, the companies concerned will be able to exploit their market power at the expense of their consumers.

The precise regulatory regimes vary between the different industries but are essentially based on a system of price caps, which set upper limits on the rate at which prices can increase — or, in some cases, set minimum price reductions. The price caps were set at privatisation, to be reviewed by the regulator periodically. They were designed to protect consumers from unwarranted price increases, and at the same time to leave companies with an incentive to seek further gains in efficiency. Since price caps were originally set at four- to five-year intervals, this

[2]The actual wording of the regulator's duty with respect to competition has varied in some cases from assisting, to securing effective competition, to promoting competition. An assessment of the current state of competition in all but one of the industries covered by the windfall tax can be found in OXREP (1997).

allowed the utilities to hold on to any profits made from additional efficiency gains that had not been foreseen at the time of the last review. At the next review, those efficiency gains would be taken into account by the regulator, and the prices that the companies were allowed to charge in the future would be adjusted downwards.

Hence part of the criticism of the regulatory regime arises from its very design, which is to allow companies to hold on to the benefits of additional cost-cutting for the period up to the next price review. It is possible that these initial price caps were not tough enough, so that the benefits of high returns achieved by some companies accrued more to shareholders than to consumers. A related criticism has been that regulators have had difficulty in obtaining accurate information from individual companies about their opportunities for efficiency gains in the future, which leads to a general tendency for price caps to be too lax. This was illustrated by the decision of the Director General of Electricity Supply, Professor Stephen Littlechild, to recalculate the electricity distribution price controls announced in August 1994, imposing new, tighter price caps less than one year later partly as a result of the information provided by the stock market reaction to his initial proposals. A third criticism has been that the impact of mistakes in the price-setting process is increased by the gap between regulatory reviews, although, in practice, these gaps have been shortened by the intervention of individual regulators, not only in the electricity sector but also in the telecommunications, gas and water sectors.[3]

These two elements — the underpricing of shares and lax regulation — encapsulate the arguments behind the tax. They are intimately related, since if regulation had been stricter in the years immediately following privatisation, the initial prices paid would have turned out to be a better reflection of the value of those shares. It is quite clear from Table 1 that most of the companies concerned outperformed the market significantly, for at least the first four years following their privatisation, and that in some cases those privatisations occurred more than 10 years ago.

III. IMPLEMENTATION OF THE TAX

The windfall tax was described as a one-off tax on the excess profits of the privatised utilities — excess profits which arose because the companies had been sold off too cheaply and regulated too lightly (enabling them thereby to exploit their market power). The method adopted of implementing the tax did not attempt to define excess profits directly, nor to define exactly what constitutes a utility, but nevertheless it finds a tax base that attempts to capture the extent to which returns

[3]A thorough review of the debate over the future of the UK regulatory regime is not possible here, but a presentation of the debate can be found in Trade and Industry Committee (1997). Armstrong, Cowan and Vickers (1994) study the UK experience of price-cap regulation, and an economic critique of profit-sharing can be found in Mayer and Vickers (1996).

earned by shareholders in the privatised utility companies were excessive and does so in a relatively simple, straightforward way. This section sets out the details of the companies covered, how the tax is distributed between the different sectors and how those amounts have been calculated.[4]

1. Scope of the Tax

The tax applies to companies that were privatised by flotation and that face economic regulation. The tax therefore encompasses the 12 regional electricity companies (RECs) in England and Wales; the 10 water and sewerage companies (WASCs) of England and Wales; the English electricity generators — National Power and PowerGen; the Scottish combined electricity generators and distributors — Scottish Power and Scottish Hydro-Electric; the company responsible for electricity transmission, distribution and supply in Northern Ireland — Northern Ireland Electricity; and British Energy, which owns part of the nuclear-powered generating capacity. Also covered by the definition were BAA (the British Airports Authority), British Gas (now BG and Centrica, after their demerger in early 1997), British Telecom (BT) and Railtrack.

Companies not privatised by flotation were not covered by the tax, reflecting the fact that it was being justified by the underpricing of shares at flotation. This definition excludes, amongst others, the National Grid, which owns the network for transmitting electricity in England and Wales. Although it could be argued that the Grid was undervalued at privatisation — it was valued at approximately £1.2 billion in December 1990 and was worth £3.5 billion five years later — payments of £50 per household in customer rebates made when the Grid was demerged from the RECs are likely to have been a factor in the exclusion of the Grid.

Given that the tax was to act as a redress for overly lax regulation, the definition includes only those companies covered by statutory regulation, where the regulator had some control over the economic environment. As a result, the tax excludes British Airways, which is not covered by economic regulation and faces a competitive international market for its product, airline flights. BAA, on the other hand, did not escape the tax. It owns, amongst other airports, Heathrow, Gatwick and Stansted, which are three of the four airports large enough to face controls over some of their charges by the Civil Aviation Authority.[5]

The scope of the tax, therefore, captures the essence of the main arguments put forward for its implementation in a pragmatic way, without entering into a debate over what defines a utility, and relies upon the existence of statutory regulation to infer market power, without attempting to quantify the degree of market power.

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[4] Details of the amounts to be paid by sector can be found in the Budget speech, while the exact calculations and the companies covered can be found in press release Inland Revenue 1, 2 July 1997, entitled 'Windfall tax'.

[5] The fourth such airport is Manchester, owned by the 10 Manchester local authorities. The price caps apply to the landing charge, the aircraft parking charge and the passenger charge.

2. Scale of the Tax

The tax is expected to raise £5.2 billion from the affected companies, as shown in Table 2. The electricity sector in total pays 40 per cent of the tax, at £2.1 billion, while the WASCs pay almost one-third, at £1.65 billion. The remaining revenue will be raised from other companies, such as BT, BG, Centrica, BAA and Railtrack. Prior to the Budget, stock market analysts estimated that a windfall tax of about £5 billion was discounted into the share prices of the utilities believed to fall within the scope of the tax.[6] As a result, while individual share prices adjusted to estimates of individual company tax bills, the utility sector as a whole did not experience dramatic price movements immediately after the Budget. There were some immediate adjustments upwards and downwards, such as those of BT, whose share price increased since it faced a tax bill at the lower end of the range expected, and Hyder, owner of Welsh Water and South Wales Electricity (Swalec), whose share price fell due to a higher tax bill than expected. The short-term adjustments are difficult to disentangle from the general reaction of the stock market to the Budget as a whole, while removing the uncertainty attached to the tax might have been as important to the performance of the utility sector as the actual amount of revenue raised and the details of the individual tax bills.

TABLE 2

Payments of the Windfall Tax, by Sector

Sector	*Tax payment*	
	(£ billion)	(%)
RECs	1.45	27.9
Generators	0.65	12.5
WASCs	1.65	31.7
Others	1.45	27.9
Total	*5.20*	*100.0*

Note: 'Others' covers BT, BAA, BG, Centrica, Railtrack and British Energy. Some of the companies have combined into multi-utilities, so that tax payments will not be made according to the sectoral breakdown given above. Scottish Power will also be liable for the payments of Manweb and Southern Water; United Utilities will be responsible for the payments to be made by Norweb and North West Water; and Hyder will be responsible for the payments of Welsh Water and Swalec.
Source: Budget speech (2 July 1997) and own calculations.

3. Method of Calculating the Tax

The tax payments are based on the difference between the value that was placed on a company at privatisation and a 'more realistic' valuation based on its after-

[6]In other words, the total market value of the utility companies believed to be affected was about £5 billion less than would have been the case if the tax had never been suggested. See, for example, *UK Weekly Analyst* (11 April 1997), Goldman Sachs.

tax profits for up to the first four years after privatisation. The tax payment will be given by

$$Tax = t\,(V_p - V_f)$$

where the tax rate, t, is 23 per cent, levied on the difference between the value on flotation, V_f, and the valuation based on profits, V_p. The value on flotation is simply calculated using the share price at flotation, *p*, and the number of shares issued, *NS*. That is,

$$V_f = pNS.$$

The valuation based on profits is found by scaling up the average of the first four full years of post-tax profits stated in the company annual report, denoted here by p, by a price earnings ratio, *pe*, set equal to 9 in all cases.[7] Hence,

$$V_p = \frac{1}{4}\left(\sum_{t=1}^{4} p_t\right) \times pe.$$

This gives an approximate market value for the firms based on four full years in the private sector. The calculation leads to the payments shown in Table 2. The tax can be paid in two equal instalments, on 1 December 1997 and 1 December 1998.

Some adjustments to this basic formula are made, in order to apportion tax payments between BG and Centrica, the demerged successors to British Gas, and in order to take account of the fact that several of the companies were not wholly privatised at their initial flotation. Where 85 per cent or less of the ordinary share capital of a company was offered for sale at flotation, both the initial market value and the estimated market value are scaled down by the proportion of shares that were actually offered for sale. This affects BT, only 50.2 per cent of which was floated in November 1984, and PowerGen and National Power, 60 per cent of which were originally floated in March 1991. This adjustment halves BT's tax bill from £1 billion to about £500 million, and reduces both National Power's and PowerGen's payments by 40 per cent.

The basic structure of the tax is quite simple, and individual tax liabilities can be calculated using publicly available information. There are several issues that arise from the use of this particular method, relating to the definition of post-tax

[7]Where four full years are not available, as in the case of British Energy (privatised in July 1996) and Railtrack (privatised in May 1996), the information on their profits earned up to April 1997 is to be used to determine the base of the tax.

profits, the use of average profits to estimate the value of the companies rather than actual market values, and the use of a single price earnings ratio rather than company-specific or sector-specific ratios.

Profit Measure

The profit measure used to calculate the tax is the after-tax profit published in each company's profit and loss account, drawn up according to accounting guidelines. This measure of profit adjusts the operating profit (i.e. the company's profit derived from its normal trading operations) for other items such as non-operating income — for example, interest and rental income — special provisions and interest charges. The measure has the advantage of being clearly defined and easy to obtain from company accounts. The role of the profit measure is to establish an alternative equity value for the companies, to compare with their equity value at flotation. This explains the use of a profit measure after interest payments have been subtracted, since payments made on debt reduce the profits attributable to shareholders.

Market Values

The estimated market value is based on the average after-tax profits earned in the four years after privatisation. Using actual market values measured by the share price times the number of shares in issue, for example at the end of the fourth full year of accounting information, would have altered the distribution of the tax slightly. The share paid by the water and electricity companies would have been reduced, with a corresponding increase in the share met by other companies. The use of actual market values would be very sensitive to the exact date chosen to measure share prices, which can fluctuate quite dramatically, even over short periods of time.

Price Earnings Ratios

The single price earnings (p/e) ratio, 9, is based on the lowest average p/e ratio calculated by sector for the relevant years. Using the lowest has the effect of only grossing up the profits of all companies by the average p/e ratio for the water sector, which was 9.3 during those years. Companies that had higher p/e ratios, on average, therefore have a lower estimated market value than they would have done if sector-specific ratios had been used, leading directly to lower tax bills. For example, if the average p/e ratio for each *sector* had been used to gross up profits, both the WASCs and the RECs would have paid closer to 25 per cent of the tax rather than 32 per cent and 28 per cent respectively. This would have been at the expense of the other companies involved, redistributing part of the tax onto the companies that had higher p/e ratios over their first four years.

It clearly would have been possible to use alternative p/e ratios, which would have made the calculation of the estimated value correspond more closely to market valuations of the profits earned by individual companies or individual sectors. The use of a single ratio simplifies the formula and reduces the scope for negotiation over whether sector-specific, company-specific, average or actual p/e ratios should be used.

This is not an exhaustive list of the questions surrounding the choice of tax base, but serves to illustrate some aspects of the method actually adopted.[8] The windfall tax takes into account the underpricing of shares at privatisation and the subsequent under-regulation of the utility companies, by including in its scope companies that were privatised by flotation and that are subject to economic regulation. It attempts to reflect the extent to which the returns to those companies were excessive through the method of calculating the tax base, without over-complicating the actual calculations. However, as the next section explains, refining the method of estimating a 'more realistic' valuation would not have addressed the central difficulty that the tax was to be levied on companies rather than on those individuals who actually received the excess returns, while it could potentially have increased the costs of complying with and enforcing the tax.

IV. THE ECONOMICS OF THE TAX

The question of how the tax was actually implemented has some bearing on whether the tax fulfils certain guidelines for tax policy. Following Leape (1990), these are whether the tax is economically efficient, whether it is fair and whether it is administratively feasible. In other words, the tax system should cause as little distortion as possible of the allocation of resources, it should distribute the tax burden fairly between individuals and it should not impose an excessive administrative burden in terms of compliance or enforcement. Although these guidelines relate to the operation of the tax system as a whole, it is possible to use them to help analyse individual taxes, bearing in mind that difficulties relating to a specific tax can sometimes be addressed through other aspects of the tax system.

1. Economic Efficiency

In economic terms, an efficient tax is one that raises revenue with as little unintended distortion of economic behaviour as possible. Given that the windfall tax is a one-off tax based on past profits, no change in the companies' behaviour today can change the level of those profits earned in the past and so alter the amount of tax that has to be paid. Therefore the only effect on the behaviour of the

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[8]For a discussion of some of the alternative tax bases being discussed before the Budget, see Chennells (1997).

companies concerned is likely to arise from the loss of income brought about by paying the bill for the windfall tax.

Since the windfall tax is levied on past profits, it has the characteristics of a 'lump-sum tax', i.e. it does not affect the cost of producing additional output and it does not affect demand conditions. As a result, the prices that firms would like to charge in order to maximise profits, given those conditions of supply and demand, do not change. Of course, the prices actually charged by these companies are subject to regulation: they are obliged to charge a price below their profit-maximising price. Given an opportunity to do so, they would seek to raise their prices, but since the windfall tax does not alter their marginal costs or demand conditions, there is no economic reason why they should be allowed to do so. The Chancellor emphasised his belief that the companies would not change their real behaviour in his Budget speech, when he remarked that 'it is my judgement that the tax can be paid without any impact on prices, investment, or the quality of service to customers; or in my view, on employment'.[9]

This leaves the question of how companies react to the loss of income. Money used to pay the windfall tax cannot also be used to finance investment spending. This implies that a higher proportion of investment must be financed from external sources, notably through higher borrowing. If an increase in borrowing raises the cost of borrowing, this will increase the cost of capital, which represents a legitimate reason for higher prices and also implies some reduction in the level of investment.[10] For many companies, this would be a serious consideration; however, for the regulated utilities, there is unlikely to be a significant effect on their cost of capital since there is little risk that these firms would be allowed to go bankrupt and little evidence that they cannot raise funds from external sources to finance their investment. Levels of one-off payments to shareholders, such as special dividend payments and share repurchases, have been particularly prevalent in the electricity and water sectors — amounting to over £7 billion since privatisation — which does not indicate that these firms expect serious difficulties in financing their planned investment, despite the uncertainty caused by the windfall tax and the possibilities of changes to the regulatory regimes under a new government.

There is one serious caveat to the assessment that, on the whole, the tax is unlikely to have a serious effect on the real economic behaviour of the companies concerned. It relates to the credibility of the statement that the tax is one-off. If

[9]The actual timing of the tax might have affected their behaviour, because the fact that the tax would be imposed was pre-announced, without any knowledge of its details. Once the policy was announced and there was a significant expectation that it would be implemented, companies might have adjusted their behaviour in an attempt to minimise whatever they believed would be the basis for the tax.

[10]Under the current system of price caps, the regulators allow companies to earn a rate of return that will cover the cost of financing their investment (i.e. the cost of capital). In addition, an increase in the cost of capital implies that some marginal investment projects (i.e. those projects that only earn a return sufficient to cover the original cost of capital) are no longer profitable.

there is a suspicion that such a tax might be imposed again, this implies that the future return on investment in the affected companies is lower than the return that would have been earned if the tax had never been suggested. To compensate for that risk, investors would demand a higher pre-tax rate of return on their capital in order to be persuaded to invest in the utilities. In other words, the cost of capital would increase for those firms, which would be likely to feed through into higher prices than would otherwise have been the case, and might lead to lower levels of investment. The fact that a windfall tax has been imposed increases uncertainty, both for the companies affected in the period before the details were known and for other companies that might suspect that they could be subject to a one-off windfall tax in the future.

2. Fairness

Whether a tax is fair becomes a more difficult question to answer when the tax is levied on companies. Although the physical payment is made by a company, the effective incidence of the tax falls on individuals: mainly the shareholders, employees and customers of the companies concerned. Exactly how the burden might be shared between these groups — through lower returns on shares held in the company, through lower wages for employees or through higher prices or lower standards of service for customers — is in general a difficult question to answer. However, in the specific case of the windfall tax, if the cost of capital does not increase for the affected companies, then much of the burden of the tax is likely to fall on shareholders. This is because, assuming that the cost of capital is unchanged, neither the level of prices charged nor the level of investment carried out should change. Given that the tax does not change the level of productivity of the work-force, there should be no economic reason for employees' wages to fall as a result of the tax. Much of the effective incidence of the windfall tax should therefore fall on shareholders rather than on employees or customers, through lower returns.

Unfortunately, because the tax is imposed at the level of the company, it is unlikely to tax all the shareholders who actually received excess profits from the privatisation of these companies in the past, and it does tax many current owners who have not benefited. The ownership of companies changes over time, and in some of these privatisations, shares sold in the first *day* of trading amounted to more than one-quarter of the shares issued. The effect of the windfall tax was gradually discounted into the share prices of the companies that were likely to be covered, in relation to the probability of being included in the tax, the probable size of the tax bill and the probability of the Labour Party being elected. Hence, different individuals earning exactly the same return in one company at flotation would bear the effective incidence of the windfall tax or not, according to whether they still held those shares on the day (or days) that the tax was discounted into that company's share price. In that sense, the tax arbitrarily taxes shareholders in the mid-1990s, for gains that in some cases were made by others in the mid-1980s.

In principle, it would be possible to identify the individuals and institutions that have owned shares in the utility companies over their lifetime in the private sector, and levy a windfall tax on them in proportion to the total return received while holding the shares, rather than taxing the utility companies. This would tax the individuals who have actually benefited from the excess profits, but would make the tax very costly to administer.[11] Unfortunately, once the windfall tax was announced as a tax on companies and discounted into company share prices according to the expectation of how much it would raise, no change could be made to the method, scope or scale of the tax without creating windfall transfers to current shareholders in the companies concerned.

3. Administrative Feasibility

A tax should be administratively feasible: it should not impose excessive costs of compliance or enforcement upon taxpayers and tax collectors. The windfall tax is based on a simple formula applied to readily available information — namely, the published accounts of the utility companies plus some additional details of the original privatisations. It is also a tax on 30 or so companies, rather than one based on individual shareholders. Thus the costs of compliance for the taxpayer should be minimal, since the tax payment is relatively easy to calculate.

There was some discussion of the costs of enforcing the tax prior to its implementation, since some of the companies that expected to be liable suggested they might challenge the legality of the tax. However, following in the footsteps of the commercial banks in 1981, also subject to a one-off tax, the utilities seem likely to find it simpler to grit their teeth and pay up on the appointed dates, rather than mount a court case with an uncertain chance of success against a tax that was a manifesto commitment of a newly elected government.[12]

V. CONCLUSIONS

The windfall tax was the subject of much controversy prior to its implementation. Its main justification was to tax the windfall gains received by owners of the privatised utility companies as a result of these firms being sold off too cheaply and subject to lax regulation in the first years following privatisation. As a tax on companies rather than on individuals, it can only capture some of those windfall gains: some of those who received windfall gains will bear the tax, while others

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[11]It would also make the incidence of the tax more transparent.

[12]The most vociferous warnings about legal challenges to the tax were made by the chairman of BT, Sir Iain Vallance, two weeks after the general election. A statement issued after the Budget by the BT board ruled out any attempt at legal action, despite criticising the inclusion of BT in the scope of the tax.

who sold their shares before it was suggested will not, and the tax will also be borne by later investors who made no windfall gains at all.

It has been constructed in a fairly straightforward way, related to the difference between the value of the firms based on the profits earned in their initial years in the private sector and the value placed on them at privatisation. It was levied on those companies that were expected to be included in the tax and raised the total amount of revenue expected. Although there are many refinements that could have been made to the actual calculation of the tax liabilities of individual companies, these would merely have increased the complexity of the tax without moving it closer to a levy on all of the actual recipients of the windfall gains.

Since the tax is based on past profits which the companies could not affect by their behaviour once the details were announced, it should have a limited effect on prices and investment in the utility sectors, provided that the statement that the tax is one-off is credible. This cannot be proved *ex ante*, and the very fact that the tax was imposed seems likely to have long-term effects on the perception of the government's preferences over tax policy.

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