Mr Hughes for filing. RW 23/5

CONFIDENTIAL

Mr Dorman ~~Mr Wilson~~

APW/369/JT

MINISTRY SEC 20/5 19 MAY 1989 CENT SEC

From Austin Wilson
US (Law and Order)
18 May 1989

response o/m To see. RW 18/5.

PS/Secretary of State (B&L)

cc PS/MofS (B&L)
PS/Mr Viggers (B&L)
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Mr A Stephens
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PETROL SMUGGLING FROM NI TO THE REPUBLIC

Through the Secretariat, the Irish Government has asked HMG urgently to consider the introduction of a unique chemical marker for petrol placed on sale in Northern Ireland in order to deal with the problem of petrol smuggling. I have been co-ordinating the preparation of advice on this subject, in which a number of Departments (including, of course, Customs and Excise) have an interest. I have accepted this task because the request from the Irish was put to us in a security context. They pointed to the link which both Governments accept exists between cross-border smuggling of fuel and the financing of terrorism.

2. Since this request was first put to us, at the end of last month, the subject has taken on a much higher political profile in the Republic. The Irish Trade Commission has been holding a public enquiry into petrol prices. A prominent article in the Irish Times of 16 May reported strong criticism by the Marketing Director of Irish Shell

Limited about the disruptive effects and the significant extent of smuggling. The Irish Press on 17 May reported that a new drive to smash cross-border petrol rackets would be launched this week by the Minister for Finance, Mr Albert Reynolds. On RTE radio yesterday, an oil industry spokesman alleged that smuggling was costing the Irish Exchequer IR£50/60 million per annum. He specifically advocated the introduction of a special colourant into Northern Ireland orginated products. We have been informed that, if there is a Conference on 24 May, Irish Ministers will certainly raise the issue. But there are indications that they may do so publicly before that. In the light of considerably raised profile which this subject now has, the Secretary of State may wish to have these necessarily brief account of the request and the implications, as we currently see them, of meeting it.

3. The Irish request is a direct follow-up to a report produced by an official Committee on cross-border petrol trade. We have been given a copy. It is very short. It concludes that the illegal importation of petrol from Northern Ireland produces a serious loss of revenue to the ROI Government (estimated at c.IR£45 million per annum in January 1989) and a very significant loss of business to the indigenous oil industry in the Republic. The Committee looked at a proposal to mark petrol consumed in the State, but this was rejected for practical reasons. The most important of these seemed to be the belief that the difference in price between the pump price of petrol in the two jurisdictions was sufficiently wide to make it worthwhile for the illegal importer to "convert" his import by inserting the ROI "marker". Instead, the Committee proposed marking petrol in Northern Ireland. This was seen as a relatively simple operation because the product comes in by sea at a limited number of terminals where the

marker/dye could be added. No unmarked supplies would then be available in Northern Ireland unless licence arrangements were in place to facilitate legitimate cross border trade. The Committee estimated the cost of this process at £0.03p/litre. It thought that this would be relatively small cost imposition on the NI market. (In fact we estimate that cost to be about £225k per annum - 750 million litres at 0.03p/litre). The Committee's argument is that this cost should be accepted because it is well known that the proceeds of smuggled oil funds "undesirable" activities on both sides of the border. It is not, however, the only cost that would need to be borne in Northern Ireland if effect was given to the Irish Government's proposal.

4. As I understand it, two forms of what the Irish see as smuggling currently take place. The "smugglers" are -

(a) those who live south of the border who go north to fill their cars with petrol; and
(b) those who bring in tanker loads for subsequent sales without declaring them to the Customs.

In Irish terms, the practice at (a) is illegal since most of those involved would not be out of the country for 48 hours and therefore not entitled to "travellers' allowances". Neither HMG nor the EC Commission accept the legality of the "48 hours rule". Indeed, the Commission has taken the Republic to the European Court of Justice on the issue. The UK has intervened <u>against</u> the Irish. Intervention was for political reasons - demonstrating HMG's willingness to support the interest of NI traders, by no means, of course, only petrol retailers - most cross-border trade is in consumer durables. As I think Ministers here would see it, only the case described at (b) above is smuggling in the true sense.

5. We have been attempting to establish what lost duty to the Irish means in terms of transactions in Northern

Ireland. Duty and VAT in the Republic is currently IR£194.8 per gallon. The figure of IR£45m in lost duty quoted in the Committee's Report therefore implies that as much as 23 million gallons (or about 105 million litres) petrol is smuggled annually. This would represent just over one-seventh of the 750 million litres of petrol which is "delivered into consumption" in Northern Ireland each year. Although at first sight this seems a very high figure, one of my own informal contact in the oil industry has given me a personal estimate that as much as 100 million litres of NI petrol funds its way to the Republic annually. He went onto suggest that, of this, approximately 60 million litres is legitimately sold to motorists from the South, ie perfectly legitimate trading as far as HMG is concerned. My contact's <u>personal</u> view was that, in the wider public interest of restricting smuggling, the oil companies would be willing to forego their revenue from the petrol which they sell legitimately but which was then smuggled in bulk into the South.

6. There is however an additional complication to HMG's interest in all this which I feel obliged to mention. All petrol lawfully imported into Northern Ireland pays duty and VAT (currently 118.4p per gallon). At a rough estimate, therefore, the amount of petrol which the Irish say (in the lowest of the estimates we have seen, ie in the official report) is smuggled into the Republic represents some £27m in Revenue VAT and duty paid to the UK Exchequer. If the "demand" for this petrol was to be removed, so also would be the receipt to the Revenue. Moreover, effectively curtailing this trade might cost fuel importers a substantial part of their existing business. It could cause serious losses also to the distributive trade; and it is possible that the effects on this amount of loss of business would be felt more widely in the Northern Ireland economy. Ministers would not, of course, wish to refrain from taking effective action to prevent cross-border smuggling simply to

prevent a loss to the UK Exchequer, but I would suggest that the "economic" argument is not one to be lightly dismissed, especially when we are still uncertain as to how much of what the Irish call "smuggling" may be legitimate in our terms.

7. Colleagues in the Department of Economic Development are trying to establish the extent to which recent substantial increases in the price of petrol in the Republic has stimulated extra "demand" in Northern Ireland especially in the border areas and how much of this demand is met by the supply of petrol to private motorists. Evidence of this kind, if it were available, might help to put the Irish request into perspective. They are also still considering whether it might be possible (if Ministers so decided) to introduce the new measure now requested by the Irish under existing subordinate, rather than new primary, legislation. It does look, however, as though the latter would be necessary. The political implications within Northern Ireland of a change of this kind, which would certainly be represented in the North as a measure from which the Republic would stand to gain far more than Northern Ireland, would probably be significant. But there is also the wider political context and 1992. At this stage, would HMG wish to be seen to be taking a step which could be representing as restraining free trade and supporting a protected industry? On one argument, it is the market imperfections resulting from the Irish Government's policies - including a state-owned subsidised refinery - which have handed this opportunity to the smugglers. But, on the other side, the Irish could argue that it was British Ministers who had urged them to take the smuggling problem seriously and that, now that they are doing so, they deserve the British Government's support.

8. A more considered submission will be put up when further information is available. But, in the meantime, I believe that the Secretary of State would not wish any interim reply to the Irish to appear too forthcoming. I have therefore advised the British side of the Secretariat that, if pressed on the matter, they should confirm to their Irish colleagues that HMG takes the problem of cross-border smuggling very seriously and that it is therefore giving the most careful serious consideration to the proposal to introduce a marker dye into NI petrol. But they should go on to say that the proposal has substantial practical, legal and economic implications which have not yet been fully considered by our Ministers.

[signed APW]

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