Stage 1 Cost Recovery Impact Statement

Cost recovery for administration of the Clean Vehicle Standard

Status quo

The Clean Vehicle Standard (CVS) was established under Part 13 of the Land Transport Act 1998 (the Act). The CVS is currently administered through the New Zealand Transport Agency (NZTA) with government funding of $11.842 million.

The CVS was introduced as part of the Land Transport (Clean Vehicles) Amendment Act 2022. The CVS aims to reduce carbon dioxide emissions from light vehicles imported into New Zealand. The CVS requires vehicle importers to meet carbon emissions targets averaged over their whole fleet, so the importation of low or zero emissions vehicles can offset the imports of high-emitting vehicles. These targets are set out in the Land Transport Act 1998 (the Act) until the year beginning 1 January 2028. For the year beginning 1 January 2028 the targets can be set and amended by Order in Council.

The Act does not currently have a mechanism by which the costs of administering the CVS can be recovered. This analysis has been written to support Budget Day legislation to:

- amend the Act to enable the amendment by Order in Council of CVS targets for the years 2025 – 2027
- amend the Act to enable cost recovery of the cost of administering the CVS.

The legislation will only enable the above activities – the legislation will not set any CVS targets. These targets are currently under review by officials.

Policy Rationale: Why a user charge? And what type is most appropriate?

The proposal is to amend the Act to enable the recovery of the cost of administering the CVS. The exact mechanism to be used in legislation will be decided at the drafting stage.

The Minister of Transport has instructed the NZTA to streamline its administration of the CVS to ensure cost recovery has the least impact possible on the vehicle import industry.

Under current settings, the CVS is paid for using general taxation. Every taxpayer benefits from the CVS through reduced carbon emissions, and contributes to the cost of administering the CVS. The CVS has several benefits:

<u>Public good benefits</u>

- Reduction in gross carbon emissions.
- Health benefits from cleaner burning of fuel.

<u>Private good benefits</u>

- Reduced vehicle maintenance costs.

- Reduced fuel consumption.

The reduction in carbon emissions is a non-excludable good. All of New Zealand benefits from the CVS and cannot be prevented from enjoying its public good benefits. In addition, the CVS compels vehicle importers to follow it, meaning they can only import a mix of light vehicles that aligns with the CVS, unless those vehicles are exempt (e.g. classic cars).

New Zealand does not have a vehicle manufacturing industry. All vehicles must be imported. While vehicle manufacturers tailor their vehicles to meet the standards of their major markets, New Zealand is a standards taker. Therefore, we have limited ability to dictate the types of vehicles that enter New Zealand apart from regulation. The CVS is an example of one of the few tools New Zealand has to achieve its policy goals.

Prior to the introduction of the CVS, the Productivity Commission noted New Zealand was one of three developed countries without a CO_2 or vehicle fuel efficiency standard. The other two countries are Russia and Australia. As a result, New Zealand has become a market that readily accepts high-emitting vehicles. This results in vehicle suppliers making a less fuel-efficient selection of vehicles available to our market, than to other markets. For example, across the top-selling 17 new light vehicle models, the most efficient variants available in New Zealand have, on average, 21 percent higher emissions than their comparable variants in the United Kingdom.

The primary benefit of the CVS accrues to the consumer.

The original 2021 regulatory impact analysis for the CVS found that the monetised benefits were:

- Fuel savings: $128.4 million
- Reduction in maintenance costs: $191.0 million (e.g. through EVs requiring less mechanical maintenance)
- Reduction in vehicle ownership costs: $32.7 million
- Reduced social cost of carbon emissions: $51.1 million.

There are additional benefits associated with lower air and noise pollution and changes in social cost of crashes due to higher quality cars being imported. These were non-monetised benefits. Overall, the benefit:cost ratio was 2.22:1.

The Ministry of Transport (the Ministry) is currently updating the cost-benefit analysis. Preliminary modelling has found the benefits of the CVS are significantly higher, but the costs are also higher. The preliminary result has reduced the benefit:cost ratio to 1.8:1. These results have a high degree of uncertainty and may change before the analysis is complete. This modelling will be complete by mid-2024, and will inform the stage two regulatory impact analysis.

As the majority of the monetised benefits accrue to the owners of new and used vehicles which are imported under the CVS, there is a strong case for majority cost recovery of the cost of administering the CVS. This is consistent with Guidelines for Setting Charges in the Public Sector.

The counterfactual shows vehicle importers also benefit from the CVS

The CVS is structured so importers can import a range of high, medium, low and zero emissions vehicles, rather than complying with an emissions cap, or series of class-based emissions caps. This enables the market to find the most efficient way of meeting the standard through a series of trade-offs across the industry.

Without this system, New Zealand would need to design either a series of caps, or enforce emissions targets through the compliance system. Either of these choices would reduce the number of available light vehicles, allow fewer product ranges, and would likely result in higher prices for consumers. In addition, the lack of either of the alternatives would result in New Zealand being the market of last resort for new and used vehicles, as producing higher emissions vehicles is cheaper than low emissions vehicles.

Other vehicle import charges are comparable

As a comparison, vehicles that enter the country must undergo a compliance process. The process assesses each vehicle against a range of requirements which include safety, pollution emissions and carbon emissions. The cost of the compliance process is wholly passed on to the end user, as the majority of the benefits accrue to them. For example:

- Safety requirements are largely a private good, as the occupants of the vehicle are more likely to survive a crash in a safer car. The public good elements of safety include the reduction of healthcare costs through less severe injuries in the event of an accident.
- Alignment with pollutant emission requirements protects the health of the occupants and the wider public, with the users of the vehicle benefiting disproportionately from the lower pollutants as they are most likely to encounter higher concentrations of pollutants.

Lower carbon emissions are more of a public benefit to the other components. However, because New Zealand has a net emissions target and transport sits within the Emissions Trading Scheme, there is no net change in overall emissions in New Zealand arising from the CVS, and therefore minimal benefits.

At this stage, we consider there are two possible options for recovering the administration costs of the CVS

There are approximately 1000 vehicle importers importing a total of approximately 300,000 new and used vehicles per annum.

At this stage, we consider there are two possible options for recovering the industry's share of the costs:

> Option 1: Spreading the administration costs equally across all vehicle importers through an annual fee. This may be the most efficient and simplest to implement. However, it would disadvantage smaller importers by requiring them to pay proportionately more relative to vehicle sales than larger importers. (Not preferred)
>
> Option 2: Recovering costs through a per-car fee. This has the advantage of greater equity but may be more complex (and therefore costly) to administer.

High-level cost recovery model (the level of the proposed fee and its cost components)

Components of the system

Administering the CVS currently has three parts: an operations function, an emissions function and a performance and compliance function.

The Operations function oversees the day-to-day delivery of the CVS, including functions such as:

- resolving issues
- managing customer accounts
- oversight of contracts and service level agreements.

Although the importation process is largely self-service, the team receives a high volume of requests for support from industry at various stages of the vehicle life cycle. These range from 'how to' queries to disputing vehicle attributes and technical calculations. After reorganisation since the disestablishment of the Clean Car Discount (CCD), the Operations function currently has 17 FTE. This may be able to be reduced to 13 FTE while maintaining current support service levels.

The Emissions function are the stewards of the data that underwrite the effectiveness of the CVS. They do this through understanding the overseas emissions standards, liaising with manufacturers and overseas government agencies, and maintaining the data used by importers to calculate their credits or charges. This function requires six FTE to maintain current service levels.

The Performance and Compliance function provides performance reporting and analytics, and monitors regulatory compliance using tools such as audits of compliance plans submitted by industry. It also has a fraud prevention function. This function has five FTE.

With the closure of the CCD, which applied a rebate for low carbon emitting vehicles and a fee for high emitting vehicles, the level of funding required to administer the scheme has been reduced to $6.37 million, as per *Table 1* below. This would leave the CVS programme with 24 FTE.

Table 1 Costs of administering the CVS

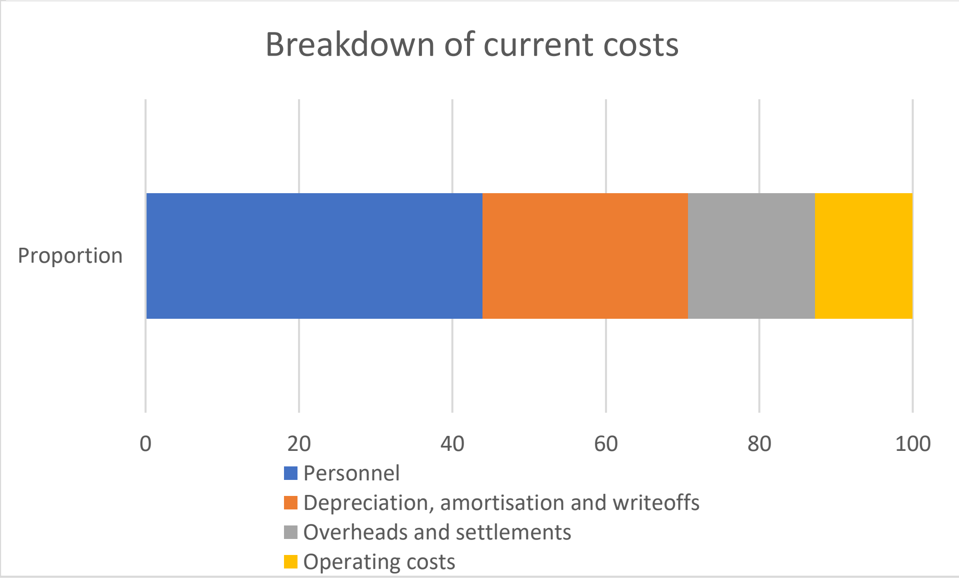
Expense type	Annual costs	
Personnel	$	2,800,833.28
Operating Costs	$	809,007.94
Depreciation, Amortisation and Writeoffs	$	1,707,260.43
Overheads & settlements	$	1,056,000.00
Total Expenses	**$**	**6,373,101.65**

Further work is required to determine how cost recovery will be applied

The administration of the CVS is currently Crown funded. Officials are still assessing whether full cost recovery is feasible. The Minister has indicated his strong preference that administering the CVS should be done without Crown funding.

The straight-line depreciation on the CVS' IT system is $1.7 million per annum. NZTA advises current service levels could not be maintained below the current staffing levels. As personnel costs represent approximately 44 per cent of operating costs (see Figure 1, below), further policy work still needs to be done to calculate the minimum viable level of funding.

Figure 1 Breakdown of current costs (%)



Design of the scheme

A fee per car is the preferred option

The Minister has indicated his preference for Option 2: a fee per car. The Minister has indicated that he would prefer the fee to be fixed at a maximum of $3 million per annum, if possible.

Using an indicative number of vehicles imported per year of 300,000, the actual cost of administering the CVS is $21.25 per vehicle. Under a fixed fee model assuming costs of between $3 million and $6.4 million, the fee would range from $10 to $21 per vehicle.

The actual costs of administering the CVS could change, depending on variables such as:

- the design of the CVS, which could change through the review it is currently undergoing
- NZTA's work to improve productivity and efficiency
- the method of cost recovery (which is yet to be determined).

Officials have not determined how the fee could be calculated

Charging a per-vehicle fee, while not the most administratively simple, ensures that the costs recovered are proportionate to the number of vehicles imported. The fee will likely be calculated by tallying up the total cost of the scheme and then dividing that by the number of vehicles imported that are subject to the CVS. There are several possibilities on how the fee could be paid.

For example, importers could pay every time a car is imported, or a yearly collated fee, or pay based on the average amount of cars imported over a certain timeframe. Other considerations include whether or not administration costs are affected by the timing of when fees are paid, and how often. Calculation will require in depth consultation with the sector and NZTA. The fees charged to importers of vehicles are yet to be determined, as industry consultation cannot occur prior to Budget.

The full fee may vary depending on the number of vehicles imported and the design of the scheme

The cost recovery may not be 100 per cent of the cost of administering the CVS. The cost of administration may change slightly over time, or year to year. The Minister has directed NZTA to lower the costs of administering the scheme, which could lead to a lowering of the fee over time. Another consideration that will need to be assessed, in conjunction with the sector and NZTA, is projections of car importation in the years to come.

The total number of cars imported under the CVS will have an impact on the fee paid over time, with increasing car importation potentially lowering the fee. An assessment of how the number of imported cars may affect the costs of delivering the CVS will need to be conducted in conjunction with NZTA.

Table 2 shows two levels of fee as a proportion of the total sale price of a vehicle, based on the cost in *Table 1* and an average 300,000 vehicles imported per year. With partial cost recovery, importers would pay a fee ranging from 0.01 per cent to 0.1 per cent of the sale price of the vehicle. Full cost recovery (approximately $21 per vehicle) would be between 0.02 and 0.21 per cent of the sale price of a vehicle.

Further options analysis will be detailed in the stage 2 cost recovery impact analysis.

Table 2 Fee as a proportion of vehicle sale price

Sale price of vehicle	Administration fee ($) partial CR	Proportion of sale price (%)	Administration fee ($) full CR	Proportion of sale price (%)
10,000	10	0.100	21	0.213
20,000	10	0.050	21	0.106
30,000	10	0.033	21	0.071
40,000	10	0.025	21	0.053
50,000	10	0.020	21	0.043
60,000	10	0.017	21	0.035

70,000	10	0.014	21	0.030
80,000	10	0.013	21	0.027
90,000	10	0.011	21	0.024
100,000	10	0.010	21	0.021

It is possible industry will pass on the costs to consumers

We consider that there are sound policy grounds for passing on the full cost of the administration of the CVS to the consumer rather than a fixed fee. Although the justification for cost recovery of CVS administration is sound, the mechanism for passing on these costs are limited. Pricing methodology is sticky, with prices approaching round numbers such as $14,995 or $24,999. It's unlikely that long-standing pricing methodologies will change, and vehicles will start being sold for $15,000 or $25,004.

However, it's possible that vehicle importers and retailers will be able to pass on the fee as an "on-road cost" when the vehicle is registered for the first time. If that is possible, full cost recovery would have little to no impact on industry, as the cost would be able to be passed onto the end-consumer.

However, we are not able to confirm how the cost could be passed on for the purpose of this impact statement (see Consultation, below).

All vehicles subject to the CVS will be required to pay an administrative fee. Vehicles not subject to the CVS will be exempt from paying the fee. This includes mobility vehicles for consumers that require them, military vehicles and classic vehicles that are desired specifically because of their age and cultural significance. These vehicles are generally required to be 40 years or older.

Consultation

Due to Budget 2024 confidentiality, we have been unable to consult with industry on the effects of this proposal. Following Budget decisions, the NZTA will consult on the detailed proposals with industry, following the standard policy process for a stage 2 cost recovery impact analysis. Affected stakeholders will include the Vehicle Importers Association and the Motor Trade Association.

Questions we would need industry feedback on include:

- Are the costs being recovered legitimate?
- What administration costs would industry incur as a result of the proposal?
- What method of recovery would have the least impact on industry?
- Would the proposal have disproportionate effects on smaller importers?
- What is the cumulative impact of import charges across government on importers?

NZTA will conduct an analysis of whether consultation with iwi Māori will be required as part of the consultation process. The Ministry will support NZTA and provide oversight of the consultation process and Treaty analysis.

Further work

Following Cabinet agreement to the proposed legislative change, officials at the Ministry and NZTA will undertake the following activities:

- seek Ministerial decisions on the proportion of cost recovery
- identify funding sources which could pay the balance of the cost of administering the CVS if only partial cost recovery is undertaken
- design the cost recovery system.