

INTRODUCTION OF A REGIONAL FUEL TAX

Reason for this briefing	You have announced that you wish to allow Auckland Council to collect a regional fuel tax with an initial focus on accelerating investment in Auckland transport projects. This briefing provides further information about introducing a regional fuel tax.
Action required	Discuss with officials. Agree to recommendations. Forward this paper to the Minister of Finance.
Deadline	None.
Reason for deadline	

Contact for telephone discussion (if required)

Name	Position	Telephone	First contact
Marian Willberg	Manager, Demand Management	[REDACTED]	X
Andrew de Montalk	Adviser, Demand Management	[REDACTED]	
Bryn Gandy	Deputy Chief Executive, Strategy and Investment	[REDACTED]	

MINISTER'S COMMENTS:

s9(2)(a) of OIA.

Date:	1 November 2017	Briefing number:	OC05381
Attention:	Hon Phil Twyford (Minister of Transport)	Security level:	In-confidence

Minister of Transport's office actions

- | | | |
|---------------------------------------|---|--|
| <input type="checkbox"/> Noted | <input type="checkbox"/> Seen | <input type="checkbox"/> Approved |
| <input type="checkbox"/> Needs change | <input type="checkbox"/> Referred to | |
| <input type="checkbox"/> Withdrawn | <input type="checkbox"/> Not seen by Minister | <input type="checkbox"/> Overtaken by events |

Purpose

1. This briefing provides you with advice on how to implement the Government's proposal to allow Auckland Council to introduce a regional fuel tax to fund land transport infrastructure in Auckland.

Overview

2. You can implement a regional fuel tax relatively quickly, using the regional fuel tax scheme introduced in 2008 (repealed prior to any regional fuel taxes actually being implemented) as a basis. However, as legislative amendment is required, a shortened parliamentary process will be required. We believe that it will be possible to have legislation passed inside the four to five month timeframe you have indicated, subject to the Government's other legislative priorities and no unexpected issues being identified.
3. There are some issues with regional fuel taxes that cannot be completely mitigated, and we propose several measures to limit the impact of these issues (in paragraphs 15 to 35).
4. Over the medium term (perhaps four – 10 years) and longer term (perhaps eight – 15 years), there are other options which do not face the same issues. In the medium term, the congestion charge being investigated for Auckland could raise some revenue that could be used for regional transport projects. It is important to note that congestion charging schemes with a strong revenue focus have not been successful overseas, so revenue collection ought to be seen as a consequence of a congestion charging scheme, and not its purpose.
5. s9(2)(f)(iv) of OIA. [REDACTED] If this approach was to be adopted, differential regional pricing should be able to be incorporated.

6. This paper is broadly consistent with previous Ministry of Transport advice on regional fuel taxes.

Interest in a regional fuel tax

7. A regional fuel tax provides a means to raise revenue for a region's transport needs from those who travel in that region.
8. Several regional or local authorities (namely Auckland Council, representatives from Greater Wellington Regional Council, Christchurch City Council and Dunedin City Council) have previously expressed interest in a regional fuel tax to:
 - fund transport projects that result in a benefit to the region
 - broaden the local authority funding base beyond rates
 - allow regions to progress projects that do not receive funding under national criteria.
9. Other local authorities may also be interested in using a regional fuel tax to fund land transport infrastructure.

10. Most notable have been the calls from Auckland Council for a regional fuel tax. [REDACTED]

11. Auckland Council sees a regional fuel tax as a way to meet part of the "funding gap" identified by the Auckland Transport Alignment Project, although we note that the funding gap may change as a result of the Government's transport priorities. A separate briefing is being provided on this.

Scope of a regional fuel tax

12. Given the broad interest in regional fuel taxes, one decision you will need to make is whether you wish the new legislation to empower only Auckland Council to put in place a regional fuel tax, or whether it should be sufficiently broad to enable other local authorities to potentially do so as well. The scheme introduced in 2008 took the second approach, with Ministerial approval required before a local authority could levy a regional fuel tax.
13. If the 2008 scheme was reinstated, you could clearly signal that the Government will only consider a regional fuel tax for Auckland. However, the option would be preserved for the Government to allow other local authorities to use regional fuel taxes in the future without legislative amendment.
14. Alternatively, if you wish to restrict the legislation to Auckland Council, then we could relatively easily change the provisions from those used in the 2008 scheme to ensure this.

Potential issues in introducing a regional fuel tax

Equity of a fuel tax

15. A regional fuel tax is only a proxy for the use of the region's roads. Fuel use varies by vehicle fuel efficiency – and fully electric vehicles use no petrol or diesel at all. This means some people will pay less tax than others for travelling the same distance.
16. While difficult to quantify, there is some evidence that a regional fuel tax will have a greater impact on low income households, which spend more of their total income on private travel costs (eight percent of total income by decile 1 and 2 households, versus six percent of total income by deciles 5 to 8). Low income households may also have older, less fuel-efficient vehicles. The average age of vehicles owned by decile 1 households is 15 years, whereas the average age of vehicles owned by decile 10 households is 11 years.
17. We can carry out further work to determine the effect of changes to fuel prices on households with different income levels if you wish.

¹ A regional fuel tax will create an additional debt facility for Auckland Council. Further work will be required to estimate the debt the Auckland Council could leverage from this.

The tax spreads beyond the region

18. Setting prices for the sale of petrol and diesel is highly complex and influenced by a wide range of factors, primarily fuel companies' desires to achieve or maintain market share. This means that fuel prices vary both between and within regions for reasons not always attributable to the cost of retailing at any particular site. Applying a fuel tax of 10 cents per litre to fuel in Auckland does not necessarily mean that all fuel prices in the Auckland region will increase by 10 cents per litre on the day the tax is imposed.
19. Prior to the 2008 scheme referred to above, New Zealand had a regional fuel tax in place between 1992 and 1996 that levied different rates for a number of the main centres. It is reported that fuel companies spread the tax across the country and did not charge a clear differential at the pump. This spreading was one of the reasons that this regional petrol tax was repealed in 1996.
20. In 2012, Auckland Council commissioned a report: *Investigation of concerns regarding a regional fuel tax*. The report, prepared by Ascan and BERL Economics, questioned both the extent and likelihood of tax spreading.
21. We do not know whether fuel companies would adopt spreading again. The majority of petrol stations are now owned by fuel companies that operate across New Zealand, which makes spreading easier even where the fuel tax is charged at a retail level. However, increased competition between fuel retailers may mitigate the potential that the tax will be spread.
22. The higher the rate of the regional fuel tax the more difficult it would be for the entire tax burden to be spread across the country. This provides a point of contrast with the tax in force between 1992 and 1996, which was 0.95 cents per litre in Auckland. A regional fuel tax for Auckland of 10 cents per litre would, if spread across the entire country, result in a fuel price increase of approximately three cents per litre.
23. We think the best strategy to mitigate the risk of spreading is engagement with fuel companies prior to introduction of the tax, to seek their views and better understand their business processes and constraints. One important part of this discussion will be where in the distribution chain it makes most sense to collect the tax (when the fuel leaves the pipeline, when the fuel is distributed to the retailer, or when the retailer sells it). There may be opportunities when making this decision to reduce the likelihood of spreading.
24. Once the tax has been introduced, we recommend that fuel prices be monitored. While there are no obvious mitigations to tax spreading, monitoring would help us to understand the extent to which spreading is occurring.

Ensuring the tax applies equitably to diesel vehicles

25. Diesel makes up approximately 45 percent of the fuel purchased for road use. We therefore recommend that diesel is included in a regional fuel tax.
26. However, between 35 and 40 percent of diesel is used off-road, on farms (tractors, harvesters), in the construction and building sector (generators, cranes) and in the broader transport sector (railway locomotives and ships). To limit the regional fuel to road users, non-road use could be excluded. Ways to achieve this would include:
 - setting up a refund scheme for fuel not used on-road, similar to the current refund scheme that exists for FED

- excluding diesel delivered directly to non-road users (for example, delivered to industrial sites).
27. Further work is required to develop these mitigations.
 28. The owners of diesel vehicles paid a tax at the pump prior to 1978. In 1978, RUC was introduced as a replacement to diesel tax at the pump as it more accurately attributed the cost of road damage to specific vehicles. RUC is calculated based on the weight and mileage of a vehicle. Introducing a regional fuel tax will involve re-introducing a substantial tax on diesel (a 0.33 cents per litre tax on diesel already exists, as discussed below).
 29. Officials have previously explored the possibility of having different RUC rates by geographical region as an alternative to a diesel tax. This approach was found not to be practicable. The key issue is diesel vehicle owners (particularly those operating large fleets) are able to register their vehicles to an address outside the region where a regional fuel tax applies.

Actively monitoring any boundary issues

30. If price spreading does not occur, then a regional fuel tax has the potential to result in customers crossing the geographic boundary of a region to buy fuel not subject to the tax. A degree of regional fuel shopping already occurs.
31. Countering this risk is that Auckland already has lower petrol prices than some of the surrounding regions. For example, on 30 October 2017, the average price of 91 petrol in the Auckland region was \$1.84 per litre, and the average price in the Waikato was \$1.92.
32. We do not believe there will be significant boundary crossing issues at the household level. While a small proportion of household travel is between regions in New Zealand, for most households, the distance to a fuel retailer outside the region is unlikely to provide a great incentive to travel there to refuel.
33. Any fuel price differentials that do exist across boundaries are much more likely to be exploited by long-distance transport operators, who will have the ability to refuel at any point of their journey. They would logically choose to refuel outside areas imposing a regional fuel tax.

Constraint on general fuel tax increases

34. Introducing a regional fuel tax might make it more difficult to achieve public acceptance of a general increase in fuel tax nationally, for example increasing the rates of FED or RUC in the future.

High cost to administer and comply with the scheme

35. Depending on the design of the scheme, it could result in high administration and compliance costs.

How can we help you to implement a regional fuel tax?

36. You have indicated that you wish to have a regional fuel tax in place in the next four to five months. The advice in this section therefore focuses on introducing a robust and fit-for-purpose scheme to fit your timeframe.

37. The ability to impose a regional fuel tax needs to be created in primary legislation. There is no such legislation in place now, but two frameworks are discussed below on which that legislation could be built.

Extend the existing Local Authority Fuel Tax

38. Local government currently collects a Local Authority Fuel Tax under the Local Government Act 1974. The Local Authority Fuel Tax applies to engine fuel (petrol and diesel) at the wholesale level. The tax has a maximum level of 0.66 cents per litre on petrol and 0.33 cents per litre on diesel.
39. The existing Local Authority Fuel Tax:
- does not require the revenue it collects to be used specifically for transport projects
 - is assessed at a point which is too high up in the distribution process to determine which region the fuel is destined for
 - applies across the entire country
 - applies to some fuel which is not used on-road, such as that used in construction and by farmers.
40. Officials have previously explored the option of modifying and raising the Local Authority Fuel Tax. Because of the issues identified above, we do not consider this is an effective option for introducing a regional fuel tax.

Use the repealed 2008 regional fuel tax legislation as the basis for a new scheme

41. In 2008, the Labour-led Government introduced a regional fuel tax scheme after a long period of consultation with local authorities and the fuel retail sector. This scheme was introduced by amendment to the Land Transport Management Act 2003.
42. The 2008 scheme required Ministerial approval for a local authority to levy a regional fuel tax. Auckland Council applied for a regional fuel tax, but was not approved by the incoming National-led Government. The regional fuel tax provisions were repealed in 2013.
43. Our initial view is that, given their similar purpose and that the legislative drafting and consultation process have been carried out relatively recently, the 2008 scheme provides a good basis for new legislation to implement a regional fuel tax. However, we need some time to check through the repealed provisions to determine the extent to which they are still fit-for-purpose, consult with stakeholders, and determine if any improvements can be made.

Legislative approach

44. Given both options require legislative change, we recommend a new scheme based on the 2008 scheme, which was specifically designed to deliver a regional fuel tax.
45. The timetable you have indicated of four to five months is shorter than the time it would normally take legislation to proceed through the House. However, it should be possible for legislation to go through all stages of the legislative process inside the four to five month timeframe you have indicated on the basis that:
 - the new regional fuel tax was closely based on the repealed 2008 scheme (reducing both policy development and drafting time)
 - a shortened legislative timetable was agreed (including either no or reduced Select Committee time)
 - the legislation had sufficient standing amongst other Government priorities.

Implementation and administration of a regional fuel tax

46. The 2008 scheme required a regional council to prepare a proposal which is then lodged with the responsible Ministers (Minister of Transport and Minister of Finance). The proposal is required to set out matters such as what the funding is required for and how that will contribute to the region's transport plans.
47. When Ministers receive a regional fuel tax proposal that they are satisfied with, they may recommend the tax be given effect by making an Order in Council.
48. The 2008 scheme gave the New Zealand Transport Agency (NZTA) the various tasks of collecting the tax, processing refunds, and managing enforcement and penalties. The systems to manage these tasks would need to be established by NZTA. This could potentially be done in parallel with the legislative process.

Other mechanisms for local authorities to fund transport

Short term

49. Transport is the largest category of expenditure for many local authorities. Local government currently contributes to the cost of local roads and regional transport projects through:
 - general rates on property – generally the higher the assessed value of the property the higher the rates
 - development contributions – amounts paid by land developers when seeking consents under the Resource Management Act 1991 and the Building Act 2004
 - specific additional rates – for example, Auckland Council has an interim transport levy on businesses and residents. The levy, due to expire in 2018, is \$113.85 (including GST) per year for household ratepayers and \$182.85 per year per business.

50. These funding sources all have the potential to provide additional funding for specific projects. Other options include:
- tolling existing roads (which would require legislative change)
 - increasing RUC and FED rates across the country
 - increasing the amount of Crown contributions
 - increasing the share that the National Land Transport Fund provides compared to the share that local authorities provide.
51. Some local authorities, as well as the Productivity Commission and yourself, have expressed interest in land-based 'value capture' as a way to fund transport infrastructure. Value capture involves collecting a portion of the benefit (for example, an increase in land value) that results from new public infrastructure. A local authority, using targeted rating powers, could potentially undertake this form of value capture and use the revenue raised to pay for transport infrastructure.
52. These short-term options would not raise the amounts needed to address Auckland's funding gap, but they should be included as part of wider consideration of transport funding.

Medium to longer term

53. New options for local government funding may be identified as part of [REDACTED]
- s9(2)(f)(iv) of OIA.
54. Congestion pricing is being considered for Auckland jointly by central and local government, and if implemented (likely at least four years away) will generate some revenue. It is unknown at this point how much revenue could be raised, and there is strong evidence from other jurisdictions that a primary focus on revenue-raising reduces the chance of successful implementation of congestion pricing because of its adverse impact on public acceptability. We will provide you with further advice on Auckland congestion charging shortly.
55. In the longer term, fuel taxes are likely to become less sustainable and more inequitable as vehicles both become more fuel-efficient and move away from being powered by fossil fuels. While FED and RUC work reasonably well at present, a range of emerging issues and the opportunities provided by developing technology suggest they will not be the best way to fund transport in the longer term.
56. [REDACTED]
- s9(2)(f)(iv) of OIA.
57. We will undertake further policy work on the future of the land transport revenue system and provide you with advice in the coming months.

Consultation on this briefing

58. The Treasury has been consulted on this paper and supports a scheme based on the previous legislation drafted in 2008 as a sensible approach.
59. The Treasury has cited the following potential issues with a regional fuel tax to date:
 - high cost of collection
 - potential for leakage at the border of the region
 - fuel companies may choose to smooth the impact across the country.
60. The Treasury notes that, despite this, a regional fuel tax would provide a new option for local government transport funding and the Treasury would support it as an interim funding source. The Treasury's view on the longer term approach aligns with that set out in paragraphs 55 and 56 above.

Next steps

61. If you agree that we should commence preparation of legislation based on the 2008 scheme to introduce a regional fuel tax, our next steps are to:
 - come back to you with advice on a range of second-tier issues such as Ministerial criteria for approval, maximum rates, legislative options and a timetable
 - commence engagement with the Ministry of Business, Innovation and Employment, the New Zealand Transport Agency, Auckland Council, Auckland Transport and the fuel companies
 - commence preparing drafting instructions for Parliamentary Counsel Office based on the 2008 legislation.
62. Given the economic implications of a regional fuel tax, we recommend you forward this paper to the Minister of Finance.

Recommendations

63. The recommendations are that you:

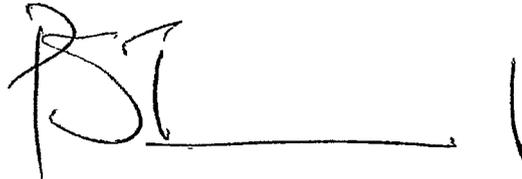
- (a) **discuss** this paper with officials Yes/~~No~~
- (b) **agree** that we prepare legislation to introduce a regional fuel tax Yes/~~No~~
- (c) **agree** that this legislation be based on the repealed 2008 regional fuel tax scheme Yes/~~No~~
- (d) **forward** this paper to the Minister of Finance. Yes/~~No~~

Marian Willberg
Manager, Demand Management

MINISTER'S SIGNATURE:

DATE:

1. 11.17



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