OFFICE OF THE
MINISTER OF ENERGY AND RESOURCES

The Chair
Cabinet Economic Growth and Infrastructure Committee

Petroleum or Engine Fuel Monitoring Levy

Proposal

1 This paper seeks agreement on policy decisions on the fuel coverage and calculation methodology (including frequency of recalculation) for the Petroleum or Engine Fuel Monitoring Levy to enable regulations to be drafted.

Executive Summary

2 In 2012, the Government decided that rather than continue to fund our International Energy Agency (IEA) oil stockholding obligation costs from general taxation, these should be funded through the Petroleum or Engine Fuel Monitoring Levy (PEFML) by expanding the purpose for which the levy can be collected. Our oil stockholding obligation is New Zealand's contribution to global oil security and is part of a system managed by the IEA to mitigate the impact of oil supply shocks by providing a buffer of emergency oil stocks that can be collectively released onto the market.

3 The Energy (Fuels, Levies, and References) Act 1989 (the Act) was amended in February 2015 to expand the purpose for which the PEFML can be collected to include the cost of compliance with our IEA oil stockholding obligation. Regulations need to be made specifying the fuel coverage and the levy rate calculation for the expanded PEFML.

4 The Ministry of Business, Innovation, and Employment (MBIE) has publically consulted on fuel coverage options and the levy rate calculation. Views differed on fuel coverage, but there was consensus on the levy calculation and frequency of recalculation. These views have been taken into account.

5 I propose that petrol, diesel, ethanol and biodiesel continue to be subject to the PEFML, as this is the most administratively simple option.

6 I propose that the levy rate should be calculated using a formula so that, over time, the levy revenue received approximately equals the costs of meeting the IEA obligation and those non-IEA departmental costs and expenses that are currently covered by the existing levy amount. This approach would require the levy rate to be renewed periodically, in response to the changing cost of meeting the IEA obligation and changing volumes of fuels levied, and changing departmental costs.

7 I propose the PEFML be set for three year periods, which will smooth the expected costs of meeting the IEA obligation over that period of time. The levy rate can be revised sooner if forecasts of the IEA obligation and departmental costs change materially during the period.

8 I estimate that the levy rate for the first three year period (from 1 July 2016) will be 0.225 cents per litre (an increase of approximately 0.18 cents over the existing rate of 0.045). The increase amounts to an additional 7.2 cents on a 40 litre tank of petrol or diesel (bringing the total PEFML cost to approximately nine cents on a 40 litre tank). Affected parties will be consulted before the levy rate is finalised in the regulations.

9 I propose to keep the existing rate of 0.045 cents per litre for a transitional period from 23 February 2016 to 30 June 2016.

Background

10 New Zealand has an international treaty obligation under the Agreement on an International Energy Program to hold oil stocks equivalent to at least 90 days of net oil imports. The government has historically met its obligation through augmenting local stocks by entering into "ticket" contracts with oil companies or traders in other IEA member countries. Stocks held as tickets in other countries are counted by the IEA as reserves for the ticket-owning country, not the country in which the stock is located.

11 The obligation to hold 90 days of net imports is New Zealand's contribution to global oil security and is part of a system managed by the IEA to mitigate the impact of oil supply shocks by providing a buffer of emergency oil stocks that can be collectively released onto the market.

12 The cost of meeting this obligation has been increasing. Rather than continue to fund it from general taxation, the Government decided that it should be funded through a levy. [EGI Min (12) 29/9 refers].

13 The Act already provides for the PEFML to be set at 0.045 cents per litre on petrol, diesel, ethanol, and biodiesel to cover departmental costs such as fuel quality and monitoring costs, as well IEA data acquisition costs.

14 The Act was amended in February 2015 to expand the purpose for which the PEFML can be collected to include "compliance by the Crown with New Zealand's obligation under Article 2 of the International Energy Agreement, to maintain the emergency reserve commitment set out in that Article".[1] The amendments also:

a. remove the maximum PEFML rate of 0.045 cents per litre of fuel (the current rate of collection) from 23 February 2016; and

b. provide for the Minister of Energy and Resources to make regulations to set the PEFML rate (or a formula to calculate rates) and fuel coverage following consultation with affected persons or organisations.[2]

15 Decisions are now required to enable PEFML regulations to be made.

16 On 21 July 2015, the discussion paper titled "*Petroleum or Engine Monitoring Levy: Consultation of Scope and Calculation of Levy*" was released to consult on whether there should be a change in the fuel coverage and the method and frequency of the levy calculation.[3]

17 Views differed on fuel coverage but the majority of submitters preferred the PEFML continue to apply to petrol, diesel, ethanol and biodiesel. There was consensus on the levy calculation and frequency of recalculation. These views have been taken into account.

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[1] Energy (Fuels, Levies and References) Act 1989, section 14(2)(ba).
[2] Energy (Fuels, Levies and References) Act 1989, section 33(3).
[3] [CBC Min (15) 2/1 refers].

Comment

18 New regulations need to be made to set the rate and fuel coverage for the PEFML so that the departmental costs such as monitoring fuel quality and IEA data acquisition, and the non-departmental costs of meeting our oil stocking obligation can be recovered.

Fuel coverage

19 The PEFML is currently collected on sales of petrol, diesel, ethanol and biodiesel (the ‘status quo’).

20 In principle, the expanded PEFML should include full coverage of all fuel products that are included in the calculation of New Zealand’s 90-day net import position. These include petrol, diesel, aviation fuels, fuel oil, ethanol for blending into petrol or diesel, and “other petroleum products” such as LPG, bitumen and solvents.

21 International aviation fuel is not considered because New Zealand is a signatory to the Convention on International Civil Aviation, which exempts jet fuel for international travel from taxation and levies.

22 The inclusion of domestic aviation fuel and “other petroleum products” is impractical as Customs’ systems do not distinguish between different uses of products. The range of products that fall under the “other petroleum products” would require technical amendments to Customs’ Working Tariff Document of New Zealand to identify and specify products subject to the levy. A separate non-Customs regime would be required to arrange collection of the levy from local producers, which would be costly and complex to implement.

23 There is no question that petrol and diesel (now collectively referred to as mineral fuels) should be covered by the expanded PEFML, but the inclusion of ethanol and biodiesel (now collectively referred to as biofuels) is less clear cut.

24 I propose that the expanded PEFML continues to include biofuels (applies to petrol, diesel, ethanol and biodiesel), which is supported by the majority of submitters. Four criteria were applied in assessing the case for including biofuels, and these are outlined below.

Exacerbator pays

25 New Zealand’s oil stock holding obligations are largely determined by the amount of all of our imported fuel and the IEA formula for net imports does not distinguish between biofuel and mineral fuel. If all of our fuel consumption was imported biofuel, we would still have an obligation to hold oil stocks.

26 However, most biofuel is currently domestically produced and demand for biofuels only marginally exacerbates the need for oil stocks. A minority of submitters believe biofuels should be excluded for this reason.

Equity

27 All fuel consumers (both mineral and biofuel) will benefit from the release of oil stock in the event of an IEA declared emergency because the price of biofuels is tightly linked to oil prices. The suppression of oil prices from an IEA stock release would also supress the price of biofuels, which would otherwise spike.

Administratively simple

28 Maintaining the status quo for the levy fuel coverage is low cost, and administratively simple, with no requirement for Customs or businesses to alter their collection systems.

Encouraging biofuel uptake

29 To some stakeholders, excluding biofuels from the fuel coverage may send a symbolic signal to encourage biofuel uptake. However, the expanded levy is initially estimated to be 0.18 cents per litre in addition to the current 0.045 cents per litre. A 0.225 cents per litre exemption on, for example, a 10 per cent ethanol blend is unlikely to make a measurable difference to fuel prices and is in itself unlikely to affect biofuel uptake.

Levy rate calculation and frequency

30 From 23 February 2016, the Act provides that the levy will be payable as prescribed in the new regulations.[4] The expanded PEFML will recover the costs of New Zealand's IEA obligations in addition to the reasonable departmental costs arising from monitoring fuel quality and providing information services.[5] The departmental costs are currently recovered at a rate of 0.045 cents per litre and I propose that this component continue to be capped at 0.045 cents per litre. As our IEA obligations in particular are likely to change annually[6] I propose the following formula to calculate the levy rate:

$$\text{Rate (cents per litre)} = \frac{\text{Forecast costs and expenses of activities in subsection 14(2) for the levy period} \;-\; (\text{or} +)\text{ surplus (or deficit)}}{\text{Forecast fuel demand for the levy period}}$$

In this formula:

- 'Levy period' means a period up to three financial years to be determined by the Minister of Energy and Resources.
- 'Forecast cost' means the forecast of the total departmental and non-departmental costs and expenses recoverable under subsection 14(2) of the Act for the levy period.
- 'Departmental costs and expenses' are the reasonable costs and expenses recoverable under subsection 14(2)(a), 14(2)(b), and 14(2)(c) of the Act (principally the costs and expenses of inspection and monitoring, disseminating safety information, and the recovery of levies).
- The forecast departmental costs and expenses may not exceed an amount corresponding to a rate of 0.045 cents per litre on forecast fuel demand in the levy period (consistent with existing policy and previous statutory rate cap).
- 'Non-departmental costs and expenses' are those recoverable under subsection 14(2)(ba) of the Act, representing the costs of meeting IEA obligations.
- 'Surplus' (or 'deficit' if costs and expenses exceeds revenues) means the estimated accumulated difference between levies and the costs and expenses of activities in subsection 14(2) of the Act between 1 July 2013 and the end of the financial year (being 30 June) immediately preceding the levy period.
- 'Forecast fuel demand' means the estimated total quantity (in litres) of petrol, diesel, ethanol and biodiesel on which the levy is payable in the levy period.

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[4] Energy (Fuels, Levies and References) Amendment Act 2015, section 5.

[5] Energy (Fuels, Levies and References) Act 1989, section 14(2)(a), (b) and (c).

[6] Ticket contract prices vary year to year depending on the state of the oil market when New Zealand goes to tender, on the volume that New Zealand tenders for, and on the exchange rate (ticket prices are set in US dollars). New Zealand goes to tender in January each year for ticket contracts that run for one year from April to March.

31 It was initially proposed that departmental costs and expenses would be recovered at a fixed rate of 0.045 cents (the current rate of collection), and would be in addition to the IEA obligation costs that would be calculated using a formula. For greater transparency and administrative simplicity it is now proposed to use a single formula to calculate all costs and expenses for activities covered under section 14(2).

32 The levy rate should be set so that the annual levy revenue received approximately equals the costs of meeting the IEA obligation (namely the cost of purchasing "tickets") and the departmental costs and expenses arising from monitoring fuel quality and providing oil information services, over time. This approach requires the levy rate to be reviewed periodically, predominantly in response to the changing cost of tickets and changing volumes of fuels levied.

33 I propose a three year period over which to determine the levy rate, which will smooth the costs over that period of time. I propose that the levy rate can be updated at any time using the same formula, if necessary, if forecasts of ticket contract costs change materially during the period. The proposed formula means that future period levy rate changes should take account of any surpluses or deficits from previous periods. All submitters agreed with this approach.

34 The Minister of Energy and Resources will review the levy rate before the end of the levy period used in the formula. IEA obligation costs will be determined by the Minister of Energy and Resources, and estimated surpluses and deficits will be calculated by the Minister. Forecasts and formula workings will be published on the MBIE website.

35 The Minister of Energy and Resources will consult with interested parties on all parameters in the levy rate formula (namely levy period, forecast costs, surplus or deficit, and forecast fuel demand) before determining a new levy rate and issuing drafting instructions to Parliamentary Counsel Office to make regulations setting that rate.

Implementation date:

36 I propose that the new levy rate will come into operation on 1 July 2016 for an initial period of three years. A commencement date of 1 July aligns with the government financial year and Customs' levy management systems. For subsequent reviews of the levy, the annual ticket price negotiations in January - February can to be taken into account when determining a new rate from 1 July of that year.

Estimated new rate and costs:

37 It is estimated that the new levy rate will be 0.225 cents per litre for the first three year period (an increase of approximately 0.18 cents per litre on the current rate).[7] The IEA oil stockholding obligation portion of the levy would amount to an additional 7.2 cents for a 40 litre tank (bringing the total PEFML cost to approximately 9 cents for a 40 litre tank).

38 The Act specifies that the levy may be applied to IEA obligation costs the Government has incurred from 1 July 2013.[8] The first levy calculation (based on 2016 to 2019 forecasts) will also take into account IEA obligation costs from 1 July 2013 to 30 June 2016.

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[7] The calculation of this levy rate is sensitive to forecasts in domestic oil production, domestic oil demand, ticket contract prices, and the USD/NZD exchange rate.

[8] The Act specifies that the levy may be applied for the purpose of maintaining the emergency reserve commitment from 1 July 2013 (section 14(3)). Audited costs to date (1 July 2013 to 30 June 2015) are $11.192 million. The first levy period will include this deficit in the calculation.

39 If the cost of tickets and fuel demand are the same, then the next levy rate could be expected to be lower as it will not include the reimbursement from 1 July 2013. However, as the costs of the IEA obligation are predicted to increase (due to a predicted decline in domestic oil production), based on current forecasts the next levy rate is expected to be approximately the same as the rate from 2016 to 2019.

40 An indicative summary of costs is set out below in Table 1.

Table 1

IEA obligation costs 1 July 2013 to 1 July 2016	Estimated annual forecast costs of IEA obligation (2016-2019)	Annual departmental costs
$16.7 million [9]	$5 million	$2.8 million

41 The current IEA obligation appropriation ("Management of IEA Oil Stocks") has a baseline of $3 million per annum from 1 July 2016 onwards. Based on the current cost of meeting the IEA obligation this appropriation will need to be increased in order to meet the cost of future "ticket" contracts. Changes in appropriation will be fiscally neutral and will be incorporated into baselines as part of the regular March or October Baseline Update process.

Transitional Period:

42 I propose to keep the existing rate of 0.045 per litre for a transitional period from 23 February 2016 to 30 June 2016. No IEA obligation costs will be met by the levy during this time. The rate to apply from 1 July 2016 will recover IEA obligation costs incurred between 1 July 2013 and 30 June 2016, and will also take into account any surplus or deficit in the recovery of departmental costs in the period 24 February to 30 June 2016.

Financial implications

43 If regulations are not made to set the rate and fuel coverage of the PEFML, current annual levy revenue of approximately $2.8 million will cease to be recoverable after 23 February 2016. The annual costs of IEA obligations, estimated at $5 million, would need to be fully funded by the Crown, with a corresponding adverse impact on the operating balance.

Consultation

44 In 2012, MBIE undertook a review of New Zealand's oil security arrangements and released a consultation paper for public discussion. The topics included fuel coverage and proposals for the levy calculation methodology. At that time MBIE received 15 submissions, two of which preferred excluding biofuels from coverage.

45 A decision was made to consult again before making the regulations and MBIE released a discussion document on fuel coverage and the levy rate calculation methodology options on 21 July 2015. Seven submissions were received.

[9] Audited costs to date (1 July 2013 to 30 June 2015) are $11.192 million and estimated costs for the year to 30 June 2016 are $5.5 million.

46 Submitters were divided on the fuel coverage options. Two submitters believe that the expanded PEFML should apply to petrol and diesel only (i.e. excluding biofuels). However, five submitters supported maintaining the status quo (apply to petrol, diesel, ethanol and biodiesel).

47 Officials consulted on a levy rate calculation formula that differs slightly from the one proposed in this paper. The discussion document contained a fixed rate (0.045 cents per litre) to recover costs under section 14(2)(a), (b) and (c) (the departmental costs and expenses) and a variable rate calculated using a formula for section 14(2)(ba) costs (the IEA obligation costs). The formula proposed in this paper sets the whole levy rate with a variable formula but with departmental costs capped at the current rate. Submitters supported the formula proposed in the discussion document and offered no comment on the fixed departmental rate.

48 All submitters agreed that the levy should be calculated using three year periods.

49 Further consultation on the particular parameters to be used in the levy rate formula (namely forecast costs, surplus or deficit, and forecast demand) will be undertaken each time a new levy rate is prescribed in regulations.

50 The Treasury, the Ministry of Transport, Ministry for the Environment, the Energy Efficiency Conservation Authority and the New Zealand Customs Service have been consulted on this paper. The Department of Prime Minister and Cabinet has been informed.

Human Rights

51 There are no human rights issues associated with the proposals in this paper.

Legislative Implications

52 The amendment to the Energy (Fuels, Levies, and References) Act 1989 expanded the purpose of the PEFML to include IEA obligation costs, and allowed the Minister of Energy and Resources to make regulations specifying the levy design and the fuels to which the levy would apply. The policy decisions in this paper will form the basis of the regulations.

Regulatory Impact Analysis

53 The regulatory impact analysis requirements apply to this policy process and a regulatory impact statement is attached to this paper.

Quality of the impact analysis

54 The Regulatory Impact Analysis Review Panel has reviewed the attached Regulatory Impact Statement (RIS) prepared by the Ministry of Business, Innovation and Employment. They consider that the information and analysis summarised in the RIS meets the criteria necessary for ministers to fairly compare the available policy options and take informed decisions on the proposals in this paper.

Consistency with Government Statement on Regulation

55 I have considered the analysis and advice of my officials, as summarised in the attached regulatory impact statement, and I am satisfied that, aside from the risks, uncertainties and caveats already noted in this Cabinet paper, the regulatory proposals recommended in this paper:

a. are required in the public interest;

b. will deliver the highest net benefits of the practical options available; and

c. are consistent with our commitments in the Government Statement on Regulation.

Publicity

56 All parties liable for the PEFML would be notified by Customs of the change in the rate and fuel coverage at least one month before the change was effected. A press release is also envisaged which would note the changes to the PEFML.

57 The Regulatory Impact Statement and this Cabinet paper will be published on MBIE's website.

Recommendations

58 It is recommended that the Committee:

a. **Note** that Cabinet agreed to collect the IEA costs of New Zealand's International Energy Agency obligation from fuel consumers via the Petroleum or Engine Fuel Monitoring Levy (PEFML) [EGI Min (12) 29/9 refers] and that the Energy (Fuels, Levies and References) Act 1989 was amended in February 2015 to implement the above decision.

b. **Note** that a discussion document *Petroleum or Engine Fuel Monitoring Levy: Consultation on Scope and Calculation of Levy* [CBC Min (15) 2/1 refers] was released for consultation from 21 July to 25 August 2015 and submissions taken into account in making these recommendations.

c. **Agree** that the fuel coverage for the expanded PEFML be petrol, diesel, ethanol and biodiesel (the status quo).

d. **Agree** that the levy rate (including the levy required for the existing PEFML revenue) be calculated using the following formula:

$$\text{Rate (cents per litre)} = \frac{\text{Forecast costs and expenses of activities in subsection 14(2) for the levy period } - \text{ (or +) surplus (or deficit)}}{\text{Forecast fuel demand for the levy period}}$$

In this formula:

i. 'Levy period' means a period up to three years to be determined by the Minister of Energy and Resources.

ii. 'Forecast cost' means a forecast of the departmental and non-departmental costs and expenses recoverable under subsection 14(2) of the Act for the levy period.

iii. 'Departmental costs and expenses' are the reasonable costs and expenses recoverable under subsection 14(2)(a), 14(2)(b), and 14(2)(c) of the Act (principally the costs and expenses of inspection and monitoring, disseminating safety information, and the recovery of levies).

iv. The forecast departmental costs and expenses may not exceed an amount corresponding to a rate of 0.045 cents per litre on forecast fuel demand in the levy period (consistent with existing policy and previous statutory rate cap).

v. 'Non-departmental costs and expenses' are those recoverable under subsection 14(2)(ba) of the Act, representing the costs of meeting IEA obligations.

vi. 'Surplus' (or 'deficit' if costs and expenses exceeds revenues) means the estimated accumulated difference between levies and the costs and expenses of activities in subsection 14(2) of the Act between 1 July 2013 and the end of the financial year (being 30 June) immediately preceding the levy period.

vii. 'Forecast fuel demand' means the estimated total quantity (in litres) of petrol, diesel, ethanol and biodiesel on which the levy is payable in the levy period.

e. **Note** that the levy period, cost and demand forecasts, and formula workings for the levy will be published on the Ministry of Business, Innovation, and Employment website.

f. **Agree** to an interim transitional levy rate of 0.045 cents per litre from 23 February to 30 June 2016 (being equal to the existing rate).

g. **Agree** that forecast revenue and expense will be reviewed as part of each March and October Baseline Update.

h. **Note** that the calculation of the levy from 1 July 2016 will be based on a three year levy period from 1 July 2016 and will include IEA obligation costs incurred from 1 July 2013.

i. **Note** that the expanded PEFML levy rate is estimated to be 0.225 cents per litre.

j. **Agree** that the Minister must determine the levy from 1 July 2016 in accordance with the formula in recommendation d and must review the levy before the end of the period used in the formula.

k. **Agree** that the default levy period will be three years, but the Minister may (in accordance with the formula in recommendation d) determine a new levy before a levy period has finished (using a period of up to three years), if the Minister deems it necessary because of a material change in forecast departmental costs, IEA obligation costs, or fuel demand.

l. **Note** the Minister, in determining the levy rates, will consult with affected parties as required under the Act on levy period length, forecast costs, surplus or deficit amounts, and fuel demand before determining the levy rate for that levy period.

m. **Invite** the Minister of Energy and Resources to issue drafting instructions to Parliamentary Counsel Office to draft the regulations needed to give effect to the above recommendations, including regulations that prescribe levy rates as determined by the Minister from time to time using the formula in recommendation d.

n. **Agree** that this Cabinet paper be published on the Ministry of Business, Innovation and Employment's website, along with the associated Regulatory Impact Statement.

Hon Simon Bridges
Minister of Energy and Resources