

05 December 2003

Minister of Transport

## INDEXATION OF FUEL EXCISE AND ROAD USER CHARGES

### Introduction

1. The Cabinet Paper on Auckland Transport: Strategy, Funding and Governance instructs officials to develop provisions for the indexation of fuel excise duty and road user charges (RUC). This brief paper explains how indexation of fuel excise duty and RUC according to the CPI could be achieved and what issues it raises that would have to be addressed. For the purposes of this paper it is assumed that indexation only applies for increases (deflation does not result in reduced taxes).
2. Over time the revenue from fuel excise has not kept up with growth in traffic, due to improving vehicle efficiencies. This trend has been to some degree camouflaged by increased economic activity and increased vehicle kilometres travelled (which are reflected in the current increase in fuel excise forecasts), but this does not reflect the actual overall reduction in excise per vehicle kilometre due to improved vehicle efficiency. In respect of diesel vehicles, of course, increased engine efficiency does not result in a reduction in RUC. However the underlying decline in yield remains and compounds the need to increase levels of income to maintain and develop the land transport system. In addition, while roading expenditure is funded on a "Pay As You Go" basis, the capital cost of roading projects is met entirely by existing users of the roading network, not by those using the project through its depreciated life.
3. There are potentially other reasons to index fuel excise and RUC beyond increased revenue for land transport. They include transport demand management and reducing emissions (e.g. carbon dioxide). However, using indexed increases on an average charge system (fuel excise and current RUC) to manage demand would be blunt (demand in congested urban areas, for example, would not decline any more rapidly than in rural areas) and is not likely to have a significant effect. Indexing fuel excise and RUC is also likely to have a small and average effect upon emissions that would not be consistent across the vehicle fleet (e.g. RUC is not charged on consumption of fossil fuels).
4. However, the underlying driver of declining petrol tax yield is technological change, as engines become more efficient and burn less fuel per kilometre run. While indexation will address the input price of

petrol in relation to inflation, it will *not* materially affect the technological imperatives that are reducing overall yield from fuel tax.

Withheld section 9(2)(f)(iv) and  
(g)(i)

### Fuel excise duty indexation

5. For the indexation of fuel excise duty to be introduced would require changes to the Customs and Excise Act 1996 in relation to motor spirits. For the indexation to carry through to the National Land Transport Fund would require amendments to the Transit New Zealand (Apportionment and Refund of Excise Duty) Regulations 1998. This would be little different from the indexation that currently occurs for tobacco and alcohol excise. However, in principle, indexation of excise on tobacco and alcohol is intended to be a disincentive to individuals consuming products that are seen as causing some direct harm to the user, while motor fuels excise is set as a charge for actual use of the land transport system. Recent changes in the levels of petrol excise have had little or no impact on actual use.
6. As petrol is a significant component of the Consumer Prices Index and input into production, analysis would need to be carried out to determine the effect on the CPI that indexation of fuel excise would have. Given the universality of petrol use in the economy, CPI indexation of fuel excise would be likely to contribute to inflation, on a different scale from indexation of tobacco and alcohol excise.
7. As well as nationwide petrol excise duty, the government has been considering the future of local authority petroleum/diesel tax over the past eighteen months. This tax is low and supplies only a very small proportion of local authority revenue.

Withheld section 9(2)(f)(iv) and  
(g)(i)

*Petrol, LPG, CNG and Ethanol*

Withheld section 9(2)(f)(iv) and  
(g)(i)

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(g)(i)

9. An alternative would be to place the LPG (and CNG) vehicle fleet on the RUC system and abolish excise for both LPG and CNG.

Withheld section 9(2)(f)(iv) and  
(g)(i)

however, any such move would have to take into account that much of the LPG fleet operates on both petrol and LPG, and that technologies such as eRUC may provide a better way of ensuring that such vehicles do not pay twice to use the roading network (through RUC and petrol excise)

Withheld section 9(2)(f)(iv) and  
(g)(i)

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(g)(i)

#### Road User Charges indexation

12. Indexation of RUC would require changes to the Road User Charges Act 1977. Revenue from vehicles paying RUC have been growing consistently in recent years, as increased kilometres travelled result in increased payments of RUC. Therefore arguments to index RUC because of declining yields do not apply. However, it would be highly distortionary to index charges for petrol vehicles, but not diesel vehicles (as this would incentivise more light vehicles to shift to diesel, and worsen emission impacts). Therefore, indexation of fuel excise should be accompanied by indexation of RUC.

Withheld section 9(2)(f)(iv) and  
(g)(i)

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(g)(i)

15. Unlike fuel excise, indexation of RUC would have two likely effects:
- Increased pre-purchasing of RUC licences in advance of indexed increases in order to avoid paying the higher rates. This would have some negative effect on expected revenue increases, although this would be partly offset by the advancing purchasing of kilometres; and
  - Increased evasion of RUC (as increased rates make it more lucrative to evade).
16. The pre-purchasing effect would be greatest with the heaviest end of the fleet, where RUC rates are comparatively high and the benefits from avoiding increases are therefore greatest. While this could be avoided by ensuring all RUC licences expire within a period of time after any increase, the government explicitly abolished such a provision in February 2002 (as it meant people had purchased licences for distance that were no longer valid). It would be a significant change in policy to reverse a legislative change made in 2002 and accordingly is not recommended. In the longer term, the introduction of eRUC with post payment would avoid such behaviour.

Withheld section 9(2)(f)(iv) and  
(g)(i)

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(g)(i)

### Implementing indexation

19. In preliminary summary, indexation of road use charges raises a number of key issues:
- Given the role of petrol in the economy, indexation of petrol tax is likely to tend to *increase* inflation rather than simply compensate for it;

Withheld Section 9(2)(f)(iv)  
and (g)(i)

Indexation will not fundamentally address the technological trends that are decreasing petrol revenue yields on a per kilometre basis. This trend is currently camouflaged by increased economic activity, but is continuing;

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and (g)(i)

**Recommendation**

20. It is recommended that you:

- i) note the issues raised in this paper; and
- ii) direct officials to undertake more work on the issues outlined in paragraph 18.

Roger Toleman  
Deputy Secretary, Strategy

Noted/agreed

Hon Paul Swain  
Minister of Transport

Date: \_\_\_\_/\_\_\_\_/\_\_\_\_

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