Ministry of Transport
TE MANATŪ WAKA

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Office of Hon Phil Twyford

BRIEFING

Discussion of trade-offs between revenue and expenditure to assist with decisions for the Government Policy Statement on land transport 2018

Reason for this briefing	To support the decisions you will take on the level of revenue for the National Land Transport Fund (NLTF) to enable delivery of your transport priorities in the Government Policy Statement on land transport (GPS) 2018. To inform whether you need Fuel Excise Duty (FED) and Road User Charges (RUC) increases to delivery these priorities.
Action required	Discuss with Ministry officials on 7 February 2018.
Deadline	7 February 2018.
Reason for deadline	To enable Ministry officials to advance the development of GPS 2018 and supporting legislative amendments if revenue changes are required.

Contact for telephone discussion (if required)

Name	Position	Telephone	First contact
Helen White	Manager, Investment	[redacted]	✓
[redacted]	Principal Advisor, Investment	[redacted]	
Bryn Gandy	Deputy Chief Executive Strategy and Investment	[redacted]	

Withheld under section 9(2)(a) of the Official Information Act 1982

MINISTER'S COMMENTS:

Date:	2 February 2018	**Briefing number:**	OC05618
Attention:	Hon Phil Twyford (Minister of Transport) Hon Julie Anne Genter (Associate Minister of Transport)	**Security level:**	In-confidence

Minister of Transport's office actions

☐ *Noted* ☐ *Seen* ☐ *Approved*

☐ *Needs change* ☐ *Referred to*

☐ *Withdrawn* ☐ *Not seen by Minister* ☐ *Overtaken by events*

Purpose of report

1. This paper provides additional information to assist your decision making on preferred revenue levels to deliver your transport priorities.

Past discussions

2. On Tuesday 16 January 2018 we discussed the GPS and the availability of revenue in the National Land Transport Fund (NLTF) to progress your transport priorities.

3. You asked the New Zealand Transport Agency (NZ Transport Agency) to provide:

   3.1. additional modelling, including possible reductions in current programmes of state highway improvements

   3.2. the draft 'shadow' Investment Assessment Framework (IAF) that has been developed to reflect government direction

   3.3. expenditure profile across regions.

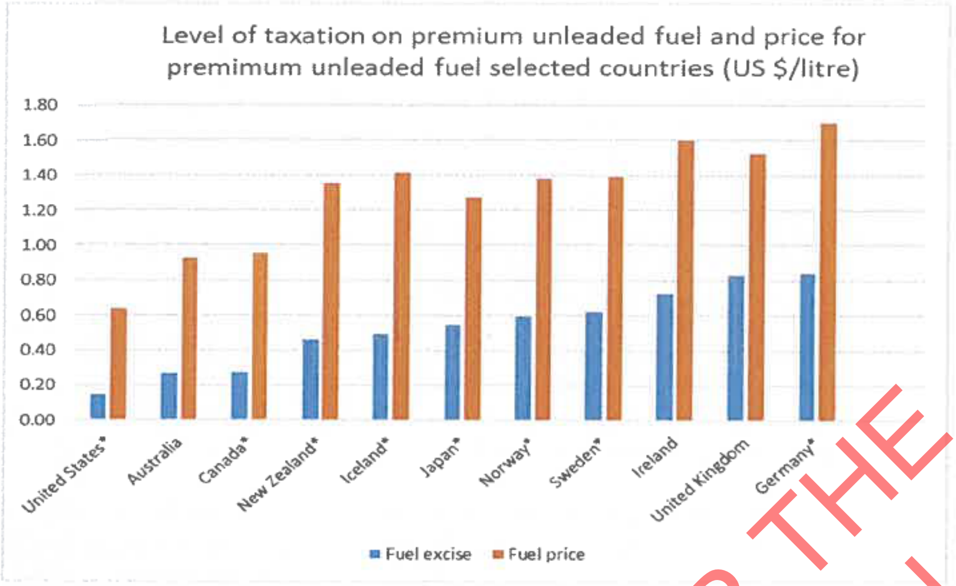
4. The NZ Transport Agency intends to provide you with this advice shortly. There will also be a discussion on these items at the NZ Transport Agency's Board meeting on 9 February 2018 and with you on 12 February 2018.

5. You also requested advice on revenue and expenditure options, draft funding ranges and indicative revenue levels to frame discussions. This paper provides important contextual information about revenue levels and options to manage expenditure. This information is used to consider the modelling of National Land Transport Programme (NLTP) revenue and expenditure levels to meet your transport priorities. The modelling is used to show you the trade-offs between revenue, expenditure and financing to deliver your transport priorities.

Revenue context

6. The current level of FED in New Zealand is 59.5 cents per litre, with the total premium petrol price at around $2.00.

7. Data published by the OECD in 2015 shows that New Zealand's rate of FED is lower than the OECD average. The graph below demonstrates the level of taxation on premium unleaded fuel across selected OECD countries.



8. Although rates of FED may be lower than the OECD average, FED has increased 44 percent between 2002 and 2015. Previous annual increases in FED and RUC have ranged between 3 and 5 cents (5 cents in 2005, 3 cents in 2009, 2010, 2013, 2014 and 2015).

9. A one cent increase in FED and RUC equivalent generates around $50 million per annum. Changes in FED/RUC will impact New Zealanders for example:

Households

10. Transport costs in general are 15 percent of household expenditure.[1] Increases in petrol costs will cause concern for some lower income groups, especially those without alternatives to private vehicle travel.

Businesses

11. Freight costs are a significant part of operating costs for some businesses. For example, a research report[2] indicated freight is 20 percent of logging industry costs and 10 percent of grocery industry costs. However, fuel costs are only a small proportion of the total freight cost.

12. We would expect that increases to the operating costs for businesses would be passed on to the consumer. Despite this, we expect the freight industry to be vocal about FED and RUC changes.

Overall demand

13. Demand for petrol is relatively inelastic. Previous fluctuations in fuel price have not had a substantial effect on the amount of fuel purchased and vehicle kilometres travelled.

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[1] Statistics New Zealand
[2] Kemp, A, Counsell, K, Cham, M & O'Fallon, W. (2012). *Transport's proportion of total costs for New Zealand businesses.* NZ Transport Agency research report 495.

Expenditure context

14. We provided advice on 15 January 2018 showing the potential expenditure implications of including the government's transport priorities within the National Land Transport Programme (NLTP).

15. The NZ Transport Agency estimated the cost of implementing the priorities was around $7 billion. This includes increased expenditure for safety, public transport services, walking and cycling, new expenditure for mass transit (City to Auckland Airport), heavy rail to support the Auckland Transport Alignment Project, footpath maintenance and demand management. This expenditure level rises to $11 billion if North-West line mass transit is included.

16. As noted, the ability of the NLTP to include new investment is constrained given the level of existing commitments and current revenue levels.

17. We are exploring how proposed changes to state highways expenditure can partially offset the shortfall, but if you wish to deliver all the government's transport priorities changes in revenue or significant cuts to current levels of service (e.g. to maintenance, public transport) will be required.

18. Previous advice showed that a one-off increase in FED and RUC of up to 30 cents per litre may be required to deliver a full programme, including rail freight. You might want to introduce a lower FED/RUC increase to match previous increases and to reduce the impact on business and households. On the other hand, you might consider that New Zealand has a low FED rate compared to European countries (noting that these countries have a policy of pricing petrol high for environmental reasons).

19. We assume you will try to minimise the level of any FED/RUC increase and consider options for you to do this.

Scenarios to illustrate the impact of revenue and expenditure changes

20. Given a desire to minimise any FED/RUC increases but also to implement a programme of investment to deliver government priorities, we have prepared scenarios which enable you to consider trade-offs between revenue and expenditure. Each scenario has an impact on the FED/RUC required.

21. The scenarios (attached) are described below:

    21.1. Base case: A scenario that reflects the current GPS 2015 settings. This is used to compare the changes as a result of government priorities.

    21.2. Scenarios 1 & 2: These options show changes in expenditure to reflect government priorities, being more for rapid mass transit and safety, and less for state highways (as a result of the application of the draft Investment Analysis Framework). They include CBD – Airport Mass Transit (funding assistance rates (FAR) of 51 percent and 100 percent), state highway programme at $15 billion.

    21.3. Scenarios 3 & 4: As per Scenarios 1 & 2, but with further decreased expenditure on state highways. CBD – Airport Mass Transit (FAR of 100 percent), state highway programme at $13 and $11 billion.

Scenario results

22. These scenarios show that decisions around the level of state highway expenditure reductions and the FAR for mass transit make significant differences to the required FED/RUC changes. They also show issues around the lumpiness of mass transit expenditure, which indicates that financing may be required (we provide some background information on financing in Appendix 1).

    22.1. Scenario 1 shows that a FED/RUC increase of 15 cents (annual 5 cents increases for three years) will cover expenditure over 10 years (at a 51 percent FAR for mass transit). Financing may be required to cover the lumpy mass transit expenditure.

    22.2. Scenario 2 shows if the FAR for mass transit increases to 100 percent the required FED/RUC increase rises to around 18.6 cents (annual 6.2 cents increases for three years).

    22.3. Scenarios 3 & 4 show the possible lower FED/RUC increases if state highway expenditure is further constrained. The FED/RUC increases fall from 18.6 cents to 14.5 (annual 4.8 cents for three years) and 10.5 (annual 3.5 cents for three years) respectively.

23. We note that Regional Land Transport Plans are prepared including expectations about state highway improvements expenditure in their region. If this expenditure is changed it will effect their expected transport outcomes for the region. The effect on their outcomes depends on the scale of any change.

Potential Impact on FED and RUC

24. To deliver you transport priorities while minimising FED/RUC increases to previous levels of increase, forecasted expenditure will need to reduce. Decisions will be required on the level of state highway expenditure reductions, reductions to service levels (e.g. maintenance or public transport) or alternatively reducing/slowing the level of planned expenditure on your transport priorities.

25. If you want to limit FED/RUC increases, our advice would be:

    25.1. a moderate decrease (i.e. to $15 billion) in expenditure on state highway improvements given the effect on Regional Land Transport Plans and the need to give local authorities time to transition to lower future state highway expenditure

    25.2. slowing delivery of some of your transport priorities – for example, footpath maintenance increases could commence later than 2018/19

    25.3. using financing to smooth the rapid mass transit expenditure.

26. However, you may wish push expenditure reductions further or raise more revenue and we will provide advice on these options and implement as required.

Activity class funding ranges

27. The level of revenue raised determines the total funding available for the NLTP. This determines the total amount available across the activity class funding ranges. Once we know the priorities for expenditure and the total funding, we can create activity class funding ranges for your consideration.

28. When we meet on 7 February 2018, we will provide illustrative activity class funding ranges based on some of the scenarios presented in this paper to begin discussions. The funding ranges will reflect:

28.1. a rapid mass transit activity class to cover the city to airport mass transit

28.2. reductions in the state highway funding expenditure

28.3. a similar level of maintenance expenditure (but including footpath maintenance)

28.4. increased public transport services, walking, cycling and regional improvements.

Next steps for developing the GPS

29. On Friday 2 February 2018 we provided a draft GPS to government departments for their feedback. This draft does not have activity class funding ranges.

30. We intend to provide you with a draft GPS and Cabinet paper on 12 February 2018. This paper will include feedback from government departments, and activity class funding ranges.

31. To provide an engagement draft we need decisions on NLTF revenue levels and activity class funding ranges.

32. If we do not have final activity class funding ranges before lodging with Cabinet on 22 February 2018, we will have to consider what other signals we can give in the engagement draft, for example, several options for the state highway funding range.

Recommendations

33. The recommendations are that you:

(a) Discuss with officials on 7 February 2018:

- your preferred level of FED/RUC and associated expenditure expectations
- the illustrative activity class funding ranges.

Helen White
Manager Investment

MINISTER'S SIGNATURE:

DATE:

Appendix 1

Financing

34. Financing allows costs to be spread over time. This can be useful to smooth large expenditure in some years, for example for rapid mass transit developments. Financing options include raising FED/RUC, third party finance (e.g. public private partnerships), Crown loans (with or without interest), and a Crown grant.

35. The implications of financing are:

35.1. the requirement to repay the capital borrowed in future years, which reduces the funds available for future NLTP investment

35.2. the requirement to repay interest or concessionary charge (for interest free loans)

35.3. possible effects on government fiscal position particularly where Crown loans are used and the impact on the Crown Balance sheet.

36. Treasury provided the following comments about Crown loans and their fiscal implications:

36.1. Under the Fiscal Management Approach (FMA), capital expenditure (that is, loans funded and repaid or recovered within a 10-year timeframe) is treated as fiscally neutral. This timeframe for fiscal neutrality could be extended if needed, but would be a departure from the FMA and may raise concerns around the creditability of the allowance framework.

36.2. For an interest free loan, or a loan at a discounted rate, there would also be a concessionary charge that would need to be appropriated. In addition, if the loan was to an agency outside the Crown then the concessionary element would need be against an operating allowance. This would have a corresponding impact on the Government's fiscal operating balance (before gains and losses). For example, the concessionary charge of the $1 billion Housing Infrastructure Fund loan over a 10-year repayment period was estimated to be $330 million.

37. We will work with the Treasury and the NZ Transport Agency to provide more detailed advice as required.