



**NEW SOUTH WALES GOVERNMENT SUBMISSION TO THE  
COMMONWEALTH GOVERNMENT'S  
INQUIRY INTO FUEL TAXATION**

**NOVEMBER 2001**

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## EXECUTIVE SUMMARY

The New South Wales Government's submission to the *Fuel Taxation Inquiry* focuses largely on the environmental matters raised in the Issues Paper of 18 August 2001. The submission also covers the history of petroleum taxation in NSW, the NSW Petroleum Products Subsidy Scheme, industry issues and rural and regional issues.

The submission recommends the following:

- An extension of the Commonwealth's *Measures for a Better Environment* program to include:
  - More comprehensive disclosure of vehicle emissions information to consumers.
  - Incorporation of incentives for the manufacture and supply of low emission vehicles into Commonwealth industry assistance programs.
  - The introduction of a differential excise to encourage the supply of low sulphur petrol ahead of its mandated introduction date of 2005.
- Changing the Commonwealth's *Photovoltaic Rebate Program's* funding structure. A better method of allocating funding is to distribute monies to the best projects and program submissions from a central pool of funds. This will reduce the use of funds on projects that return low benefits.
- Promoting the use of alternative fuels through:
  - The removal of the excise on biodiesel blends in the *Excise Tariff Act*.
  - Amending the *Diesel and Alternative Fuels Grants Scheme Act 1999* to include biodiesel as an alternative fuel.
  - The inclusion of ethanol-diesel blends (diesohol) in the *Diesel and Alternative Fuels Grants Scheme*.
  - The listing of biodiesel at the same price as ethanol (under sub-regulation 7(1) of the *Diesel and Alternative Fuels Grants Scheme Amendment Regulations 2000*) with an additional excise grant equivalent to current diesel subsidies/grants.

The Submission also raises other issues and makes comments in relation to:

- Support for the retention/continuation of Commonwealth programs that promote alternative fuels.
- Support for continuation of the Commonwealth's *Renewable Remote Power Generation Program* past 2004-05 and subsidisation of renewable energy schemes that replace the use of diesel in remote areas. However, the allocation of funding under this program is inequitable. The current RRPGP structure does not provide remote NSW households the same access to rebates for renewable energy systems as provided to identical households in other States with large funding allocations.

- The Inquiry's Issues Paper suggests that fuel excise could be extended to all fuel products as a way to maintain taxation revenue from substitutes for petroleum products in the future. This suggestion is premature. In Australian road transport, CNG and LPG industries do not have established markets, refuelling infrastructure or the economies of scale to enable lower fuel costs to be passed on to the consumer. Additional taxation would hinder their development.
- The new *Energy Grants (Credits) Scheme* should take into consideration the potential destruction of the consumer biofuel market due to administrative complications for individuals applying for the rebates.

## SECTION 1: INTRODUCTION

The New South Wales (NSW) Government welcomes the Commonwealth Government's latest inquiry into fuel taxation, and acknowledges the Commonwealth's sole responsibility for the taxation of petroleum products in Australia.

The timing of the Inquiry is particularly appropriate in view of the major reforms to indirect tax that were implemented from 1 July 2000. The Inquiry joins a long list of over 40 inquiries at various levels of government over the past few decades that have examined petrol pricing issues.

Fuel is the largest contributor to Australia's greenhouse gas (GHG) emissions. Therefore it is both logical and necessary that the structure of Australia's fuel taxation and related rebates, subsidies and grants addresses the production of GHG and the associated environmental externalities. The Inquiry provides an opportunity to develop policy settings which better reflect environmental objectives and responsibilities while also meeting consumer needs and Government revenue requirements.

The NSW Government's submission therefore largely focuses on environmental issues with respect to fuel taxation. The submission discusses the role of the excise-free status of some fuels, elements of the *Measures for a Better Environment* program, environmental outcomes from the use of fuel, air quality environmental objectives, and the Commonwealth's excise differential between leaded and unleaded petrol.

The submission also sets out a brief history of petroleum taxation in NSW, an outline of the NSW Government's *Petroleum Products Subsidy Scheme*, and a number of relevant regional and industry issues with respect to fuel taxation.

## SECTION 2: HISTORY OF PETROLEUM TAXATION IN NSW

While the NSW Government no longer directly taxes petroleum products, or imposes business licence (franchise) fees, the arrangements for taxation of petroleum products in NSW have changed several times over the last three decades.

### 2.1 Petroleum Franchise Licence

A petroleum licence fee was first implemented in NSW in March 1975. This fee was based on a percentage of petroleum product sales in the preceding financial year. Flat charges were also imposed on operators selling petroleum products.

The licensing scheme ceased from July 1976 but was reinstated in September 1982. From that date all wholesalers of petroleum products were required to take out a monthly licence. The revenue collected funded upgrading and maintenance of NSW roads.

Licence fee concessions were provided in northern New South Wales in five zones descending from the Queensland border. These concessions varied from 100 per cent (in the zone closest to Queensland) to 20 per cent of the licence fees.

## **2.2 3x3 Fuel Levy**

The 3x3 fuel levy was introduced in 1989 as a 3 cents per litre (cpl) surcharge on petroleum licence fees. The additional revenue went towards road improvements and road safety.

The legislation underlying this levy was effectively invalidated by a High Court decision in August 1997. Since then therefore NSW has not levied licence fees or the 3x3 surcharge.

## **2.3 Safety Net Revenue Payments**

To replace revenue lost from franchise fees to the States, the Commonwealth at the States' request increased its taxation on petroleum products. This safety net funding effectively replaced NSW's lost revenue.

A condition of the Commonwealth's safety net provisions was that petrol prices were not to increase because of this arrangement. As a result, in December 1997 NSW introduced subsidies for off-road fuel use. Interim subsidies were also paid to the major oil companies from August 1997 to November 1997.

Safety net payments ceased from July 2000 as part of the agreed national tax reforms – as set out in the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations* (the *Intergovernmental Agreement*). This agreement also required the States to abolish off-road diesel subsidies from July 2000.

## **SECTION 3: NSW PETROLEUM PRODUCTS SUBSIDY SCHEME (PPSS)**

### **3.1 Off-road Diesel Subsidy Scheme**

Under the former NSW petroleum franchise regime, off-road diesel fuel was exempted (as noted above). To ensure that the safety net arrangements did not increase the price of off-road diesel fuel, the NSW Government introduced a subsidy. This was paid on diesel sales to holders of an Off-road Diesel Permit, and boat owners. The subsidy was identical throughout NSW (at 1 February 2000 the rate was 8.35 cpl).

From July 2000, consistent with the *Intergovernmental Agreement*, NSW stopped subsidising diesel fuel for off-road and marine use. The scheme cost NSW \$125 million in 1999-2000.

### **3.2 NSW Queensland Border Petrol & Diesel Scheme**

NSW also introduced a scale of petroleum and diesel subsidies for on-road use in northern NSW. This scheme is necessary for petroleum retailers and other businesses in northern NSW to remain competitive with Queensland.

(As Queensland did not levy petroleum franchise fees, it was required to provide subsidies for all petroleum products. This reduced Queensland petrol prices to around 8 cents per litre below NSW prices, resulting in different levels of petroleum product taxation between the two States.)

NSW continues to pay the border subsidy following the Queensland Government's decision in 2000 to retain its scheme in the new tax environment. The NSW subsidy scheme cost \$39 million in 2000-01.

### **3.2.1 Administrative Arrangements**

The NSW Office of State Revenue (OSR) administers the PPSS via the *Petroleum Products Subsidy Act 1997* and its Regulations.

Under the legislation, subsidies are payable to retailers or their suppliers in one of five northern NSW zones. In practice, the payments are made to petroleum distributors (with retailers' consent) provided the subsidies are passed on to the retailers. Not doing so may lead to cancelling of registration and entitlement to further subsidies. Payment is made via a monthly subsidy application. The subsidy decreases with distance from the Queensland border (see table below for the current rates).

| <b>Zone</b>     | <b>Petrol<br/>(cents per litre)</b> | <b>On-road Diesel<br/>(cents per litre)</b> |
|-----------------|-------------------------------------|---|
| <b>1</b>        | 8.35                                | 8.35  |
| <b>2</b>        | 6.68                                | 6.68  |
| <b>3</b>        | 5.01                                | 5.01  |
| <b>4</b>        | 3.34                                | 3.34  |
| <b>5</b>        | 1.67                                | 1.67  |
| <b>Residual</b> | Nil                                 | nil   |

Subsidies were indexed twice-yearly. When Queensland stopped indexing its petroleum subsidy, NSW fixed its subsidy rates at pre July 2000 levels.

### **3.2.2 Effectiveness of the PPSS**

In September 2000, OSR reviewed the PPSS, with a second review in May 2001. The review followed claims by the Australian Automobile Association's (AMA) in May 2000 that the subsidies were not being fully passed on to end-users.

In its review, OSR liaised with the Australian Competition and Consumer Commission, the Service Stations Association, the AMA and the NSW Department of Fair Trading.

On both occasions, OSR found no evidence that the zonal subsidies were not being fully passed on to motorists. Pricing differences were due to the oil companies' marketing practices rather than the subsidies not being passed on.

## **SECTION 4: ENVIRONMENTAL ISSUES**

### **4.1 Environmental Outcomes: What are the main environmental outcomes from the use of fuel?**

#### **4.1.1 Air quality environmental objectives**

The *National Environment Protection Measure (NEPM) on Ambient Air* establishes the standards and goals against which Sydney's air quality is measured. In Sydney, ozone levels exceed the 1 hour NEPM standard on about 15 days a year and the 4 hour level on about 5 days a year.

Particle (PM10) concentrations sometimes exceed the 24 hour level of the NEPM standard (particularly when there are large scale hazard reduction burns or bushfires). The dominant underlying cause of these urban air quality problems is the emissions from motor vehicles.

#### **4.1.2 Environmental outcomes from motor vehicles**

Control of emissions from both petrol and diesel fuelled vehicles is fundamental to reducing the precursor ozone emissions of oxides of nitrogen (NO<sub>x</sub>) and volatile organic compounds (VOCs), and particles. In Sydney, motor vehicles are the major source of emissions of NO<sub>x</sub> and VOCs which are the major ozone precursors.

The *State of the Environment Report 2000* identifies that motor vehicles account for 70% of NO<sub>x</sub> emissions and 52% of VOCs emissions in the Sydney region. Motor vehicles, particularly those fuelled by diesel, are also a major source of particle emissions – 23% in the Sydney region.

#### *4.1.3 Alternative fuels programs*

The NSW Government supports programs to promote the use of alternative fuels such as compressed natural gas (CNG) that provide clearly demonstrated environmental and economic benefits. Such programs should be clearly targeted to address barriers to the commercial uptake of such fuels and include environmental performance criteria that ensure environmental benefits are realised. They should also be designed to encourage continuous improvement in vehicle technology and fuel quality.

The Government has contributed significant resources toward the promotion of CNG as a transport fuel. Displacing diesel with CNG greatly reduces emissions of harmful particulates and also cuts emissions of other air pollutants and greenhouse gases. Sydney Buses has the largest fleet of natural gas vehicles in Australia, with 304 CNG-fuelled buses currently in service and another 100 due to be delivered by the end of 2002.

The Government has provided financial support for a trial of CNG-fuelled trucks by Waverley Council and for conversion of fleet vehicles by Liverpool Council. It established the Western Sydney Natural Gas Vehicles Task Force to promote natural gas as a transport fuel through partnerships involving fleet operators, fuel and vehicle suppliers and all three levels of Government. Through the Roads and Traffic Authority,

the NSW Government provides technical advice to Councils and other fleet operators on the opportunities for conversion to CNG.

#### **4.2 Measures for a Better Environment: Effectiveness of current measures and possible alternative approaches**

At present the Commonwealth's *Measures for a Better Environment* program encompasses a variety of elements including higher emission standards for fuels and new vehicles; subsidies to convert heavy vehicles to Compressed Natural Gas (CNG), Liquefied Petroleum Gas (LPG); support to develop a *Diesel National Environment Protection Measure*; a \$400 million Greenhouse gas abatement program, and the *Energy Grants (Credits) Scheme*. The program could be extended to cover:

- ***Emissions advice to consumers*** – *The Commonwealth has introduced a fuel consumption label for passenger vehicles. This program should be extended to provide information on the relative contribution of different vehicles to urban air pollution (i.e., relative emissions of particulates, oxides of nitrogen, hydrocarbons, and carbon monoxide). Such a program would enable consumers to make “greener” choices and encourage manufacturers to supply vehicles that perform better than required by minimum standards. The program should also be extended to all light vehicles (i.e., below 3.5 tonnes GVM), including large four-wheel drives now commonly used as urban passenger vehicles.*
- ***Vehicle Technology Program*** – *Low emission vehicles (e.g., hybrids, fuel cell vehicles, etc.) are difficult to introduce into Australia's small and highly competitive market. Consideration should be given to incorporating incentives for the manufacture and supply of such vehicles into existing Commonwealth industry assistance programs and taxes/charges on vehicles.*
- The introduction of a differential excise to encourage the supply of low sulfur petrol (150ppm – parts per million) ahead of its mandated introduction date of 2005 – *Measures for a Better Environment* currently includes the introduction from January 2003 of a 1 cpl excise differential for diesel fuel with a sulfur content higher than 50ppm. The differential increases to 2 cents per litre from 2004. Similar provisions should apply to encourage the supply of low sulfur petrol.

#### **4.3 Measures for a better environment: Renewable Remote Power Generation Program**

The *Remote Power Generation Scheme* (RPGS) continues to be contentious issue between the NSW Sustainable Energy Development Authority (SEDA) and the Australian Greenhouse Office (AGO). The Government supports continuation of the scheme beyond 2004-05 and the subsidisation of renewable energy schemes that replace use of diesel in remote areas.

The NSW Government administers the *Renewable Remote Power Generation Program* (RRPGP) to over 3,700 remote households in NSW that currently use diesel generation.

The current RRPGP structure does not provide remote NSW households the same access to rebates for renewable energy systems as provided to identical households in States with large funding allocations. NSW will receive approximately \$200,000 per year under the RRPGP. This is only about 0.5% of total RRPGP funds. This allocation is inequitable and not sufficient to ensure that the objective of “helping to provide an effective electricity supply to remote users” is met in NSW.

#### **4.4 Measures for a better environment: Commonwealth Photovoltaic Rebate Program**

The Commonwealth *Photovoltaic Rebate Program* (PVRP) will provide support for off-grid householders in NSW. The PVRP is available in all States, and does not eliminate inequities in funding between jurisdictions. The PVRP will also expire either next year if all funds are spent, or else the year after, however the program may be extended for a further two years. This leaves a period of up to two years in which remote NSW households and the NSW sustainable energy industry will receive no Commonwealth support, while other States will receive combined RRPGP support of up to \$45 million per year.

This has the potential to greatly harm the NSW sustainable energy industry.

The Commonwealth Government has allocated large portions of RRPGP funds to Western Australia, Northern Territory, and Queensland on the basis that these States have greater levels of state-operated diesel power generation. However, the funding allocations for these States are so large compared to NSW that there is a high likelihood that funds will be directed to projects in other States that are of less benefit in terms of achieving RRPGP objectives than potential projects in NSW for which there is negligible support.

A more sensible method of allocating funds is to maintain a central pool of funds, to be distributed to the best project and program submissions. This will enable funds to be directed to the projects and programs with greatest benefit and maximum abatement of diesel use, and reduce the use of Commonwealth funds for low benefit projects.

#### **4.5 Measures for a better environment: Life cycle emissions**

The life-cycle emissions of fuels should be considered when evaluating environmental outcomes from the use of different fuels. Such analysis should include fugitive emissions that may occur during production, transmission and use, and their total GHG per GJ or per km travelled.

#### **4.6 What is the scope to substitute other transport fuels for petrol and diesel?**

There is significant scope to substitute petrol and diesel with alternative transport fuels, including renewable fuels derived from biomass such as biodiesel and ethanol.

However, careful consideration should be given to the full spectrum of environmental issues and potential impacts on the market.

Ethanol is already used in NSW as a 10% blend with petrol, which is sold at a small number of independent service stations. There is considerable scope for increasing this market. However, careful attention needs to be given to possible impacts on urban air quality, which requires consideration of the method and level of blending and the season and location of use.

Biodiesel is a semi or fully natural replacement for petro-diesel that can be used in the majority of standard and turbo charged diesel engines. There are no technical limitations on the use of biodiesel on petro-diesel engines.

Biofuels could be used for both urban and regional transport in NSW. Use of biodiesel in Sydney Harbour and other waterways would significantly reduce the toxic environmental effects of petro-diesel, whilst cleaning up the waterways. There is also potential for use of biodiesel in trains, buses and passenger vehicles, particularly in regional areas.

The production of biofuels (including ethanol and biodiesel) may involve significant environmental benefits and /or impacts (eg salinity, biodiversity) that vary considerably by fuel type and source. Lifecycle assessment of fuels should account for such benefits and impacts.

Another fuel that is attracting interest from vehicle manufacturers is liquid hydrogen, which can be derived from natural gas or renewable sources. The use of hydrogen from renewable sources in fuel cell vehicles is often proposed as a long-term goal in sustainable transport. As an interim step, one major manufacturer proposes using liquid hydrogen derived from natural gas to fuel conventional internal combustion engine vehicles, and is exploring the potential for Australian participation in a worldwide series of trials.

It should be noted, however, that emerging new vehicle technologies (eg hybrids, fuel cell, as well as alternative fuels) offer opportunities for reducing the environmental impacts of vehicle use and the economic and security costs of oil dependence.

#### **4.7 What is the scope in other sectors to substitute other fuels for petrol and diesel?**

There is significant scope to replace petro-diesel with biodiesel in diesel-powered generation units. There is no technical reason preventing the use of biodiesel in petro-diesel generators. This would save 50-80% in GHG emissions. According to the 1999 *Phase 2 Draft Report Summary of Diesel – RAPS*, prepared by Energy Strategies for the Australian Greenhouse Office, there are over 3,700 remote households in NSW that currently use diesel generation. There are a number of diesel generators bordering on national parks and wilderness areas, such as Lord Howe Island. The use of biodiesel would reduce the environmental risks and effects associated with petro-diesel in these vulnerable locations.

#### **4.8 Do the current fuel tax, rebate, subsidy and grant arrangements influence environmental outcomes?**

##### **4.8.1 Taxation and pricing of alternative fuels**

There are important emission reduction benefits associated with using alternative fuels such as CNG compared to current emissions from petrol and diesel fuels. The commercial viability of this fuel is critically dependant on current Commonwealth assistance provided in the form of an excise free status and inclusion in the *Diesel and Alternative Fuels Grant Scheme* (or the *Energy Grants (Credits) Scheme* replacing this scheme from July 2002).

Alternative transport fuels such as CNG, LPG and ethanol produced from biomass carry no Commonwealth excise in Australia. If these fuels are not supported by special assistance measures they would probably be uncompetitive against low cost oil products (to which an excise of 40.5 cpl and 38 cpl applies to unleaded petrol and diesel, respectively).

**Prior to the introduction of the GST, both CNG and LPG offered lower fuel running costs compared to diesel. Post GST, compensation measures have been put in place that retain an advantage for CNG and LPG fuel as follows:**

- Commonwealth *Diesel and Alternative Fuels Grant Scheme*. This scheme commenced in July 2000 and allows transport operators that are eligible for the diesel fuel grant to also be eligible for alternative fuel grants. Ethanol is included under this Grant scheme;
- Subsidy program for alternate transport fuels. Under this program \$18 million per annum is provided for CNG and LPG vehicle conversion assistance for buses and other commercial vehicles; and
- *Compressed Natural Gas Infrastructure Program*. The \$7.6 million program is designed to facilitate the establishment of a national network of CNG refuelling stations.

Retention/continuation of measures of this kind is essential from an environmental perspective.

##### **4.8.2 Commonwealth's excise differential between leaded and unleaded petrol**

The role of the higher excise on leaded petrol will no longer be relevant after 1 January 2002, as from that date Commonwealth environmental fuel standards (which include the banning of lead from petrol) take effect.

##### **4.8.3 Impact of the urban and rural differential in the treatment of diesel**

**The Commonwealth's diesel fuel grant of 18.51 cpl is available for on-road vehicles of 4.5 tonnes or greater that operate in non-metropolitan areas but only**

**for vehicles over 20 tonnes operating in metropolitan areas. The rationale for this distinction is to lower industry costs in rural and regional areas while avoiding encouraging an increase in diesel use in urban areas. Such a shift to diesel in urban areas would worsen air pollution, especially levels of hazardous fine particles that are of increasing public health concern.**

Successive audits identified numerous administrative shortcomings in the Commonwealth's long established Diesel Fuel Rebate Scheme, including leakage and overpayment. Effective administration and enforcement, therefore, will be essential to ensure that similar problems do not emerge over time with the much more widely available diesel fuel grants.

In view of the significant public health risks associated with an increase in diesel use in urban areas, it is proposed that an improved data collection and reporting system be established to enable the early detection of any such shift. Accordingly, NSW proposes that the Commonwealth collect and publish annually for major urban areas the retail sales volumes of transport fuels by fuel type including petrol, diesel, CNG, LPG, etc. Such a reporting system will also assist with the implementation and evaluation of Commonwealth and State greenhouse, air quality and alternative fuels policies.

#### **4.9 Should tax, rebate, subsidy and grant arrangements be used to address environmental impacts from fuel use?**

The Inquiry's *Issues Paper* suggests that fuel excise could be extended to all fuel products as a way to maintain taxation revenue from substitutes for petroleum products in the future. This suggestion is premature. As noted above, promotion of alternative fuels is an essential part of sound air quality management regimes.

In Australian road transport, CNG and LPG have only a small market share and there is only minor commercial usage of ethanol and no commercial usage of methanol and biodiesel. These industries do not have established markets, refuelling infrastructure or the economies of scale which would enable lower fuel costs to be passed on to the consumer. Additional taxation would only hinder or halt their development.

Various alternative fuels and vehicle technologies (e.g., fuel cells, hybrids, etc.) that offer potential for reducing the environmental impact of vehicles are available or emerging. Existing assistance programs do not cover all of these. Moreover, vehicle and fuel technologies and markets are changing rapidly, and it is not clear which approaches will ultimately prove superior in economic and environmental terms. Current policies fail to take account of changes over time in the relative environmental benefits of different fuels and technologies.

The inquiry, therefore, might consider options for moving towards a performance-based approach that provides incentives for superior environmental outcomes, rather than picking individual fuels for preferential treatment. As discussed above, this should involve environmental outcomes being assessed on a life cycle basis that accounts for land and water as well as atmospheric impacts (e.g., salinity impacts/benefits of biofuel crops).

#### **4.10 How do the current fuel tax, rebate, subsidy and grant arrangements influence fuel use decisions? / Is there a role for fuel taxes, rebates and grants in influencing the allocation of resources in the economy?**

##### *4.10.1 Fuel Excise*

The current excise on biodiesel “blends” hinders use of the fuel and places a barrier to investment in the production and marketing of biodiesel and hence the growth of the biofuel industry.

Although the *Excise Tariff Act 1921* does not mention biodiesel, the Australian Taxation Office (ATO) has given preliminary advice that biodiesel itself does not attract excise tax. That is, if the biodiesel is sold in the neat, or 100% pure form, then no excise tax is payable.

However, biodiesel is primarily used in blends. For example, in France it is mandated that all diesel be cut with 5% biodiesel. In the United States, B20, that is diesel with 20% biodiesel, is recognised as an alternative fuel. A small amount of biodiesel can be added to regular diesel to eliminate the sulphur that is presently used as a lubricant.

It is recommended that biodiesel be given parity with fuel ethanol in the *Excise Tariff Act* (by way of a simple addition to Section 6G of the Act to remove the excise on biodiesel blends).

The removal of excise will aid in achieving the NSW Sustainable Energy Development Authority’s “greenhouse objectives” of commercialising the sustainable energy industry in NSW through the development of the biofuel industry. The loss of potential taxation revenue would be mitigated through revenue generated from the growth of the biofuel industry, which would largely be regionally based, and a reduction in the externality costs associated with GHG emissions.

##### **4.10.2 Grants**

The use of “alternative fuels” should be encouraged; the receipt of a grant for the use of an alternative fuel will act as an incentive for such use.

The *Diesel and Alternative Fuels Grants Scheme Act 1999* includes in Section 5, the definitions section of the Act:

“**Alternative fuel** means:

- a) compressed natural gas; or
- b) liquefied petroleum gas; or
- c) recycled waste oil; or
- d) ethanol; or
- e) canola oil; or
- f) such other fuel as is specified in the regulations.”

It is recommended the legislation be amended to include biodiesel as an alternative fuel.

In the Regulations under the Act, in Section 7 of the *Diesel and Alternative Fuels Grants Scheme Amendment Regulations 2000 (No.1)*, there are various rates per litre that relate to the grants available under Section 11 of the Act. Sub-regulation 7(1) states: “the amounts per litre that are applicable to the following types of diesel or alternative fuel are:

- a) for diesel fuel – 17.798 cents;
- b) for compressed natural gas – 12.132 cents;
- c) for liquefied petroleum gas – 11.466 cents;
- d) for ethanol – 20.009 cents.”

It is recommended that in order to achieve parity with ethanol, biodiesel be listed under sub-regulation 7(1) at the same price as ethanol with an additional excise grant equivalent to current diesel subsidies/grants.

Subsection 7(2) states:

“(2) An amount that is applicable to a fuel specified in sub regulation (1) does not apply to a blend of that fuel and another fuel, whether or not the other fuel is specified in that sub regulation.”

Hence, a blend of diesel and ethanol do not qualify for a grant even though both are specified in the subregulation. This makes the use of ethanol-diesel blends (diesohol) virtually impossible.

It is recommended that blends be acceptable under the grants scheme in order to promote the use of alternative fuels.

#### **4.10.3 Rebates**

The use of biofuel excise with a “rebate” for its use could destroy the consumer biofuel market due to the administrative complications for individuals applying for the rebates. The new *Energy Grants (Credits) Scheme* should take this into account.

## SECTION 5: INDUSTRY ISSUES

### 5.1 Taxation treatment of fuel used by primary producers

Petroleum products, and particularly diesel, are significant inputs to New South Wales' agricultural industries. This reliance can be seen from Table 1, with fuel, oil and grease comprising 7.1 per cent of the total cash costs of broadacre industries in 1998-99.

| Industry                | Fuel Expenditure | Total Cash Costs | Fuel Proportion |
|-------------------------|------------------|------------------|-----------------|
| Wheat & Other Crops     | \$27,340         | \$310,730        | 8.8%            |
| Mixed Livestock & Crops | \$13,750         | \$184,750        | 7.4%            |
| Sheep Industry          | \$6,280          | \$89,080         | 7.0%            |
| Beef Industry           | \$4,190          | \$90,360         | 4.6%            |
| Beef Sheep Industry     | \$4,950          | \$104,460        | 4.7%            |
| Dairy Industry          | \$7,140          | \$180,850        | 3.9%            |
| All Broadacre           | \$10,710         | \$150,800        | 7.1%            |

Source: Australian Farm Surveys Report 2000, pp 76-102

While the farm-gate price of fuel fluctuates with world oil prices and exchange rates, Commonwealth excise on diesel and unleaded petrol, at 38.143 cpl, presently makes up nearly half of the on-road price of these fuels. Primary producers are currently eligible for a rebate of the entire excise on diesel used for off-road purposes but must bear the full excise on petrol. GST is returned through the availability of input tax credits.

The present tax discrepancy between petrol and diesel may impose efficiency costs on the economy by encouraging the use of diesel engines in applications better suited to petrol engines. To the extent that burning diesel is more damaging to the environment than burning petrol, this substitution effect may also impose environmental costs.

New technologies are presently being developed to convert agricultural commodities into petroleum fuel substitutes. These include the production of:

- ethanol from high starch, relatively low value grains such as corn, or waste wood material such as forest trimmings. Ethanol production from grains has become a multi-billion dollar industry in the US, with ethanol production exceeding 1.6 billion gallons in 2000 and being the third largest market for US corn. Interest in ethanol production in Australia is growing;
- "bio-diesel" from low-value tallow, a by-product of the livestock industry. Construction of Australia's first commercial bio-diesel plant is being planned for Perth later this year; and
- the blending of rapeseed oil with methanol to produce a fuel with properties similar to diesel.

The increased use of such renewable and cleaner-burning fuels offers significant new marketing opportunities for New South Wales primary producers, as well as an opportunity for import substitution. However, consideration should be given to the environmental and economic issues in relation to the use of taxation to encourage investment for the development of processing capacity for alternative fuels.

## **5.2 Public Transport**

Transport (both private and public) is one of the largest items of household expenditure and, as some food is exempt from GST and residential accommodation is input taxed, transport is probably the largest household item subject to GST. The New Tax System has made some elements of private car travel less costly, and public transport more expensive.

While doubts remain about whether savings from the removal of embedded indirect taxes have been passed on (from suppliers of diesel, spare parts etc), the Commonwealth's *Alternative Fuels Conversion Program* has helped fund the purchase of low emission CNG buses by State Transit.

Special fuel levies to fund public transport have been applied in Germany. This option could be explored by the Inquiry, and its deliberations might inform the National Transport Secretariat's (NTS) preparation of an *Emissions Abatement Package for Urban Transport* (undertaken for the Australian Transport Council).

## **5.3 Utilities (electricity, water, natural gas)**

Petrol and diesel used in the supply of electricity, water and natural gas represent a relatively small cost to these utilities, so petrol/diesel prices and taxation are not a significant area of concern.

## **5.4 Implications of petroleum prices/taxation for petroleum stocks**

The NSW Ministry of Energy and Utilities is responsible for the administration of petroleum supply disruptions. To minimise working capital and stockholding costs, petroleum retailers and distributors often maintain quite low stock levels. Storage capacity is therefore under-utilised and consequently, in periods of fuel supply disruptions, service station stockouts can occur relatively quickly.

The level of stockholding may increase if the wholesale petroleum price (including excise) were lower. Increased stockholding of petroleum products would act as a buffer to short term petroleum supply disruptions.

## **5.5 Competitiveness**

Generally Australian industries benefit from a relatively low level of fuel taxation and pricing, compared to most other OECD countries. Hence, Australian industries are competitive internationally in relation to their fuel taxation burden.

One of the key issues in relation to domestic fuel competition is the lack of adequate access to alternative sources of wholesale fuel. The recent reforms to indirect taxation did not include initiatives to increase competition at the wholesale and retail levels of the oil industry, for example by encouraging independent oil companies or by promoting the capacity of retailers to shop around for the cheapest wholesale prices.

## **SECTION 6: RURAL AND REGIONAL ISSUES**

Two issues of significant concern to regional businesses and communities are fuel price differentials between regional centres and the continuing differential between country and city fuel prices.

Neither of these issues is directly related to the Inquiry's *Terms of Reference*, and will not form part of the Inquiry's deliberations. These issues have been the subject of numerous previous inquiries, and have yet to be resolved satisfactorily in the eyes of regional communities.

High fuel prices have long been a source of concern for regional NSW. The causes of higher country petrol prices have been the subject of considerable debate, and despite the large number of previous inquiries into the issue, the differential remains. This is a source of regional concern primarily because regional communities have limited recourse to public transport and often large distances to travel for services.

The Commonwealth introduced, as part of its indirect tax reform package, the *Fuel Sales Grants Scheme*, which provides a 1 cpl grant to registered retailers in non-metropolitan areas and a 2 cpl grant to retailers in remote areas. The Australian Competition and Consumer Commission's (ACCC) special powers to monitor the extent to which these savings are passed on to regional motorists are welcomed.

In relation to the taxation of fuel, regional NSW and metropolitan areas have both been affected by higher than expected impacts from the introduction of the GST. The adequacy of the 6.7 cpl reduction in fuel excise to compensate for the GST is questioned.

The 1998 *A New Tax System* (ANTS) package assumed a petrol price of 77 cpl and indicated that petrol excise would be cut by a flat 7 cpl so the GST would not increase prices. However, motorists paying more than 77 cpl faced higher prices under the reforms.

**Fuel excise was eventually cut by a flat 6.7 cpl in July 2000 with the Commonwealth assuming that there would be further savings of 1.5 cpl as a result of tax reform. The notion that there would be 1.5 cpl savings as soon as the GST was introduced has been widely called into question. Indeed, the ACCC indicated in its *Report on the Movement in Fuel Prices in the September Quarter 2000* that savings would be a maximum of 0.2cpl in 2000-01.**

Notwithstanding the Commonwealth's fuel grants scheme of 1 cpl for non-metropolitan and 2 cpl for remote areas, which has operated in addition to the 6.7 cpl reduction in fuel excise since July 2000, the grants scheme did not adequately compensate consumers for the impact of the GST. This has been ameliorated to some

extent by the reduction of fuel excise by 1.5 cents per litre, effective from 1 March 2001. Regional industries have benefited from this decision.

Key regional industries such as agriculture and mining also benefit from the DFRS. The Commonwealth has indicated that the Inquiry will not result in either a reduction in diesel fuel rebates paid to farmers or an increase in diesel or petrol taxes, and this will be welcomed by regional industries currently receiving this assistance.