QUEENSLAND GOVERNMENT SUBMISSION TO THE COMMONWEALTH FUEL TAXATION INQUIRY

THE QUEENSLAND GOVERNMENT SUBMISSION TO THE COMMONWEALTH'S FUEL TAXATION INQUIRY

Queensland is a geographically dispersed State reliant on the fuel dependent tourism, agricultural and mining sectors for export revenue. In the agricultural and food manufacturing industries, for example, internationally competitive raw material costs and air freight costs are significant factors affecting these industries' profitability.

The State is also reliant on an extensive transport system to deliver services to businesses and the community in an efficient and timely manner. High fuel prices impact on the cost of delivery of goods and services to rural communities and place an additional burden on the limited financial resources of these communities. Rural communities also rely extensively on road transport to send their produce to markets on the eastern seaboard and to overseas markets. The cost of fuel increases the landed cost of products and reduces the return to the producers. As a result, the cost of fuel for residents particularly in regional, rural and remote areas of Queensland is a key factor impacting on the State's economic growth and residents' quality of life.

Specific comments relating to issues raised in the Issues Paper.

ADMINISTRATION AND MEASURES FOR A BETTER ENVIRONMENT: BOX 5.3

General Administration

Queensland Fuel Subsidy Scheme

The design of Queensland fuel subsidy scheme changed significantly in 2000 to move the point and timing of payment of subsidies. Rather than paying the subsidies for all consumers at the wholesale level so that end users purchase subsidised fuel, the retail subsidy is now paid to retailers for fuel sold and the bulk end user ("BEU") subsidy is paid to BEUs for fuel used. These changes were essential to eliminate abuse of the previous arrangements through the transport of subsidised fuel interstate for resale in breach of the scheme conditions.

Moving the point and timing of payment has increased compliance costs by imposing record keeping obligations on claimants and requiring detailed claims information. It has also increased the number of registered claimants. For BEUs, it also means that claiming the subsidy in arrears rather than being entitled to purchased subsidised fuel.

The Office of State Revenue consulted with the fuel industry on the changes in 2000 and is continuing to work with the industry to improve administration arrangements to minimise paperwork without affecting the scheme's integrity. A number of improvements to the administration arrangements have already been implemented following those changes and the scheme is being monitored to identify other options for improvement.

It needs to be remembered, however, that Queensland has the most generous fuel subsidy arrangements of any State or Territory, which means significantly lower fuel costs for business and private consumers compared with those payable by consumers interstate. The cost of the administration arrangements therefore must be balanced against the benefit of lower fuel costs and the need to prevent abuse of the scheme at significant cost to the community.

Interaction with Commonwealth Schemes

The existence of the various Commonwealth and State subsidy and grant schemes causes confusion for fuel users. The different policy objectives of each scheme means that there are different rules for:

- licensing or registration;
- entitlement to subsidies or grants;
- payment (ie payment in advance, on purchase or in arrears on usage).

In designing the changes to the Queensland scheme, detailed consideration was given to the extent to which alignment with the Commonwealth schemes was feasible. However, the different policy objectives of the various schemes and Queensland's objectives for the changes to its scheme meant that direct alignment was not possible.

Options for possible closer alignment of aspects of the scheme with the various Commonwealth schemes will continue to be considered as part of the on-going process of review of the Queensland scheme to improve its operation. The Queensland Government remains open to working with the Commonwealth to review administration arrangements across all Schemes to develop options that reduce administration costs for Government and consumers.

Off-Road Diesel

Responsibility for off-road diesel subsidies is an area of particular concern. As pointed out in the Issues Paper, the Commonwealth's new off-road scheme does not provide comprehensive coverage for off-road diesel consumers. Certain industries, such as construction, are ineligible under the Commonwealth scheme. The Issues Paper explains (at p.28 para.2) that the original proposal to extend the off-road scheme to include all off-road business use of diesel fuel did not proceed following negotiations with the Australian Democrats. Those negotiations resulted in the scheme being extended to rail and marine transport only.

As a result, there is a group of fuel users who do not receive the same level of Commonwealth assistance for their off-road fuel as other off-road fuel users. The Queensland Government has been wrongly criticised for this unfair outcome. The affected consumers blame Queensland because it abolished the off-road subsidy from 1 July 2000. However, the Commonwealth's commitment in *A New Tax System* was to take over full responsibility in this area and to retain the related fuel excise revenues.

This outcome creates an anomaly in the operation of the Commonwealth's off-road diesel subsidy and is unfair to those industry sectors that miss out on that subsidy. The Commonwealth should amend its off-road diesel subsidy scheme to ensure that all users who were previously eligible for a subsidy under the former Queensland scheme still qualify under the Commonwealth scheme. The Queensland Government has raised this issue with the Commonwealth previously.

Measures for a Better Environment

Cleaner Fuels

It is appropriate for fuel tax, rebates, and subsidy and grant arrangements to be used to encourage the earlier availability and use of cleaner fuels.

Currently there is no Commonwealth excise on Liquefied Petroleum Gas (LPG), and therefore there was no reduction as per other petroleum products with the introduction of the GST. Therefore, LPG moved from being a non-taxed petroleum product to a product that bears the full amount of the GST (notwithstanding that business consumers receive an input tax credit). While LPG remains relatively inexpensive compared with petrol and diesel, its price has risen relative to other fuels as a result of national tax reform.

LPG is a cleaner burning fuel than petrol or diesel and with the possible introduction of constraints and additional costs on greenhouse emissions, the conversion of a substantial number of vehicles to LPG could help to achieve any potential emissions targets imposed on the Australian community. Furthermore if carbon emissions targets are imposed, LPG will attract less of an increase in price than many other fuels since less carbon permits (assuming a trading system is introduced) will be required than with petrol or diesel.

While the environmental benefits of switching to LPG could be substantial, technological progress may make LPG less attractive in the long run. When alternative non-emitting or polluting sources become available (such as fuel cells that use clean burning hydrogen), LPG will still be a polluting fuel.

The initiatives announced by the Commonwealth in the *Measures for a Better Environment* indicated that an excise differential would be established between ultra low sulfur diesel fuel and higher sulfur diesel in order to encourage early adoption of clean fuels. The differential excise on 50ppm sulfur diesel will enable the early availability of Euro 4 diesel engine technology, with substantially reduced emissions of oxides of nitrogen and particulates. Given the historically high differential between diesel and motor spirits, the Queensland Government's preference is for a carrot, rather than stick, approach to adopting a differential for diesel. That is, the differential should be achieved via a reduction in excise for low sulfur diesel.

As yet, measures to implement this initiative have not been undertaken. This failure to follow through on stated policy has had a major impact on the BP and Caltex refineries in the Australia TradeCoast. The Australia TradeCoast is a Queensland Government initiative to develop a major global trade and industry hub on the East Coast of Australia. It consists of 5000 hectares of industrial land at the mouth of the Brisbane River and incorporates Brisbane Airport and the Port of Brisbane. These impacts on the refineries are outlined below.

(1) BP Bulwer Island Refinery

Following the Commonwealth Government policy to establish an excise differential on diesel, BP's Bulwer Island refinery committed an investment of A$250 million in clean fuel technology. Associated investments were also made by alliance partners, taking the total new investment at Bulwer Island to the vicinity of A$500 million.

No ultra low sulfur diesel (ULSD) has been produced at Bulwer Island. The impact of these investments is adversely affecting BP's profitability.

(2) Caltex Lytton Refinery

Unlike BP's Bulwer Island refinery, the Caltex Lytton refinery has not shown any sign of making a decision on moving on this matter until the Commonwealth implements its policy to establish an excise differential in favour of ULSD. The Commonwealth's failure to implement the policy has had a significant impact on the Lytton refinery. While Caltex has commenced planning work on a clean fuels technology investment at Lytton, it will continue to refrain from committing to an investment in ultra low sulfur diesel technology (in the vicinity of A$80 million) until the latest possible date, possibly late 2003.

(3) Refinery Integration

The Commonwealth *Downstream Petroleum Products Action Agenda 1999* noted the improved competitiveness that the Australian refining industry could achieve through joint venture refinery operations (pp 61). The BP Bulwer Island and Caltex Lytton refineries in Australia TradeCoast are in close proximity to each other. The refineries also possess complementary plant configurations. Consequently, they are potentially the most capable of the eight Australian refineries of advancing toward joint venture refinery operations. Indeed, the Australia TradeCoast Task Force (ATCTF) is actively facilitating process integration and other forms of integrated operations in conjunction with BP and Caltex.

It is anticipated that some of the benefits arising from the improved competitiveness and scale that would be derived from integration may include (a) significant petrochemical projects and (b) an optimised transition to production of ULSD and "clean" gasoline. It is also noted that a smooth transition toward integration could be achieved as a result of the minimisation of combined expenditure on clean fuels technology and maximisation of process and feedstock synergies.

However, the Commonwealth's failure to implement its stated policy of an excise differential between low and high sulfur diesel is proving to be a major impediment to the ATCTF's efforts to broker refinery integration. It has created an uncertain climate for investment that is having a significant impact on industry in Australia TradeCoast. Unlike diesel, it is not proposed that an excise incentive be applied to gasoline (petrol). Consistent application of the principle of an excise differential in favour of clean fuels may also have a positive impact on industrial development in Australia TradeCoast.

<u>Fuel quality standards</u>

The national fuel quality standards, when they come into force progressively from 1 January 2002, are expected to make an important contribution to reducing emissions of local air pollutants from motor vehicles. These standards are expected to be particularly effective because they will immediately reduce emissions from all vehicles in the fleet, not just from new vehicles, as would be the case if emission standards in the Australian Design Rules for motor vehicles were tightened.

Additionally, the availability of cleaner fuels in Australia will allow vehicle manufacturers and importers to use the latest technologies for vehicle emission control that generally only work properly when clean fuel is used.

Nevertheless, more needs to be done. Fuel quality requirements beyond 2006 need to be articulated as soon as possible so that refiners can decide on the most cost effective way of meeting both medium and longer term requirements. This is significant as it is likely that, at least in the short term, new fuel technologies will have a greater cost of production, placing upward pressure on prices.

RESOURCE ALLOCATION, ENVIRONMENT, PRICING: BOX 6.1

Resource Allocation

Renewable energy

Renewable energy sources that offer social, economic and environmental benefits should continue to benefit from favourable taxation levels. Renewable fuels have the potential for a range of benefits including:

- Reduced net emissions of air pollutants and greenhouse gases;
- Reduced environmental risk from fuel leaks or spills because of greater biodegradability;
- Improved economic base for rural and regional areas and reduced fuel transportation costs and impacts because of renewable fuel production and use in these areas;
- Reduced disposal costs and impacts for organic wastes that are converted to fuel;
- Greater efficiency through co-generation (for example, the development of fuel cell technology to generate electricity in houses when not in use in vehicles); and
- Less reliance on imported fuel.

Alternative Fuels

An issue to be considered in relation to the taxation treatment of alternative fuels is the often neglected costs associated with assessing the rationale for, and means of effecting a transition to an alternate mode of fuel use. While life cycle assessments (LCA) and eco-efficiency audits can be written down as legitimate business expenses, the initial costs incurred in pursuing this option can be prohibitive, especially for small to medium enterprises operating on tight margins and small cash flows. It may well be the case that a tax concession in excess of a full right down of LCA and eco-efficiency audits could assist this process. This proposal however, involves not only issues relating to fuel taxation and price signals, but also issues relating to business taxation and R&D credits.

Transport system

Queensland has a number of objectives and strategies for the transport system to which fuel prices are relevant. These strategies support improved transport planning and environmental outcomes by encouraging use of public transport and integrated freight solutions.

The current Diesel and Alternative Fuels Grants Scheme does not apply to urban buses and therefore does not encourage the use of urban public transport in a consistent manner. To assist in reducing cost pressures on the urban transport system it would be preferable if this scheme was altered to be consistent with these other policy objectives.

Another issue of concern is the method of transporting fuel across country. The tax regime may be able to be used to influence the transport arrangements and achieve safer and more environmentally friendly outcomes. Transportation by rail or sea should be clearly preferred for long distance movement where that is an available option.

Environmental Outcomes

It is appropriate for fuel tax, rebates and subsidy and grant arrangements to be used to encourage industry and consumer choice towards fuels with the lowest potential for environmental harm. However, it is important that there be a sound scientific basis for determining which fuels to favour, taking into account full life cycle analysis of emissions. Full fuel cycle analysis needs to be broad enough to capture all significant environmental impacts associated with the production, processing, refining, transporting and usage of a fuel, including for example, for fuels produced from crops, the effects of agricultural practices on farm run-off and water quality.

Other mechanisms that are being used to manage environmental outcomes from fuel use include:

- Fuel quality standards;
- Emission standards for new motor vehicles; and
- In-service vehicle maintenance requirements.

Due to the large contribution that motor vehicles make to local air pollution problems and greenhouse gas emissions in Australia, and the complexity of the issues involved, it is appropriate to use all of these methods, as well as fuel tax, rebates, subsidy and grant arrangements, in a concerted effort to create enduring improvements.

Pricing, Cost Structures and Marketing Arrangements

The Queensland Government has been a vocal critic of the variability in petrol prices, in particular, the significant price rises before weekends and public holidays by many major retailers. There are a number of options available to Australian Governments to help limit fuel price variability. It is likely that the benefits to motorists will be in the form of more predictable prices, rather than lower average prices. However, the effectiveness of the options can vary widely and it is critical that there is a national approach to the problem of fuel price variability.

On a broader level, the Queensland Government believes that any changes to pricing, cost structures and marketing arrangements must be cognisant of the need to promote a fair treatment of independent operators throughout the fuel industry. The viability of this group is critical to maintaining competition within the industry, an essential element in reducing fuel prices.

Education Program

One of the simplest, but most effective, initiatives the Commonwealth could undertake is to fund a national consumer education program. This would cover all relevant aspects from how fuel prices are set and influenced, to fuel pricing cycles and alternative fuels.

This would allow motorists and businesses to adjust their purchasing practices to maximise savings. The program could be funded from the windfall revenues the Commonwealth has received from the Petroleum Resource Rent Tax .

Twenty Four Hour Price Fixing

The Queensland Government does not support the introduction of 24-hour price fixing. The results of Western Australia's 24-hour price fixing initiative are not encouraging. The initiative has not generated significant consumer savings, was expensive to implement and administer and does not have the support of major business or consumer groups or independent fuel retailers.

Perhaps most seriously of all the initiative appears to have had an adverse impact on the operations and viability of independent fuel retailers – who remain the consumer's best mechanism for fair and competitive petrol prices.

Limited Variation Petrol Prices

An alternative is the trial of price limitations - where prices could only rise within a set number of cents-per-litre (cpl) each day, with no limit on price decreases. Critical issues for any trial would include determining the amount that prices can be varied each day, establishing an appropriate industry code to self-regulate the scheme and determining appropriate penalties and sanctions.

Self-regulation by the oil industry has proven problematic and ineffective in the past and there is no guarantee that many of the unsatisfactory elements of 24-hour price fixing would not translate to the Limited Variation model. Accordingly, there is significant doubt amongst industry and consumer groups as to whether this approach will provide an enduring solution to the problem of price variability.

Terminal Gate Pricing (TGP)

In Queensland, an effective model of TGP is widely supported. While the Victorian model is viewed as a good start, there is a clear need for improvements - primarily making TGP more transparent. A transparent nation-wide TGP system is the most effective way to ensure fairer competition for smaller retailers and independents, by ensuring equitable access to supply, and generates significant benefits for consumers as price fluctuations are minimised without excessive price regulation.

Two points are most critical, namely: TGP should be implemented as a nation-wide initiative; and, fuel must be listed and supplied at an "unbundled" price, ie. a price that excludes costs such as marketing and transport and allows retailers to decide those extras they wish to pay for.

This Government supports the Australian Competition and Consumer Commission (ACCC) proposal to improve the Victorian model by implementing:

- TGP accompanied by open access; and
- TGP that does not include price discounting.

THE ECONOMY, REGIONAL, RURAL AND REMOTE COMMUNITIES, CONSUMERS, EXTERNALITIES AND GOVERNMENT REVENUE: PART 7:

The variability of fuel prices can be less 'painful' for businesses and consumers if Government imposts, and therefore prices, are as low as possible. In this area, the Queensland Government is leading the nation, as we are the only State that fully compensates consumers - saving motorists over 8 cpl.

Although the Commonwealth Government has now removed automatic indexation of fuel excise, it has not fairly dealt with other relevant and significant pricing issues.

Reduction of Excise to Provide Additional Compensation for the GST

The Commonwealth reduced excise to ensure retail prices did not increase as a result of the introduction of the GST. The excise reduction was predicated on a "strike price" of 90 cpl, resulting in a GST payable of 8.178 cpl. In June 2000, the Commonwealth announced an excise reduction of only 6.656 cpl, with the additional 1.5 cpl reduction required to achieve a neutral outcome for motorists to be derived from fuel companies' cost savings from the abolition or reduction in other taxes under A New Tax System (ANTS).

However, the Commonwealth's assumption that savings of 1.5 cents a litre would eventuate was erroneous as it was based on long term estimates and assumed an appreciation in the exchange rate.

The error of the Commonwealth's assumptions was confirmed by the ACCC in its Report on the Movement in Fuel Prices in the September Quarter 2000, which concludes that "the cost savings to industry could be up to 1.6 cents per litre in the long term. The timing and magnitude of these savings is uncertain in the short term".

The fact that cost savings to fuel companies were overestimated by the Commonwealth was also confirmed in a report by Econtech, commissioned by the Australian Automobile Association. Both the Econtech and ACCC reports estimated that the savings arising from ANTS were only 0.4 cents a litre, i.e. the Commonwealth actually increased tax paid by motorists by 1.1 cents per litre.

Commonwealth Fuel Sales Grant Scheme

In July 2000, the Commonwealth introduced the Fuel Sales Grants Scheme to compensate for the differential impact of the GST between metropolitan and rural and regional prices, as the GST is levied on a higher price base in rural and regional areas. The grant is 1cpl in non-metropolitan areas and 2 cpl in remote areas. For remote areas where fuel prices are beyond $1.20 per litre, fuel retailers may apply to the ATO for an additional grant.

Although the Queensland Government supports the introduction of the Fuel Sales Grants Scheme, the current amount does not counter the true impact of the GST in non-metropolitan areas.

While it is recognised that external influences have been largely responsible for rapidly rising fuel prices, the introduction of the Goods and Services Tax (GST) has also had an impact on both metropolitan prices and the widening of the disparity between city and country prices. The factors mainly responsible for this have been:

- rapid increases in crude oil prices following the setting of the GST "strike rate" in July 2000;
- the failure of the new tax system to adjust the excise level to compensate consumers for the increasing GST burden due to rising retail prices;
- the Commonwealth not passing on the full reduction in excise to compensate for GST but expecting industry to find the difference from savings at an unachievable level; and
- the inadequacy of the subsidy levels available under the Fuels Sales Grants Scheme to deal with the rapid increase in crude oil prices resulting in higher country retail prices thereby widening the city/country disparity.

There are also problems with the index used to determine classifications, the Accessibility/Remoteness Index of Australia (ARIA), which need to be rectified to ensure that maximum assistance is provided to those areas most in need of support. The ARIA measures remoteness as accessibility to service centres. In developing ARIA, "effort focused on disadvantage in terms of accessible services, especially those routinely available to people in metropolitan areas". The index project was generated out of concerns over health data and the health status and service availability in remote areas.

Such an index, primarily concerned with service provision issues, will not necessarily identify areas that experience particularly high petrol prices. Therefore, a number of anomalies have arisen. For example, the Melbourne Airport is classified as regional, with motorists receiving a 1 cent per litre subsidy even though it is less than 30 minutes from the Melbourne city centre. The Queensland city of Roma is also classified as regional even though it constantly has one of the highest measured petrol prices. According to the Informed Sources Internet Site, the average price of unleaded fuel in Roma in September 2001 was 93.8 cents per litre. After adjusting for the Queensland Government Subsidy this equates to an underlying price of 102.1 cents per litre. A 1 cent per litre subsidy has a very small impact in this context, particularly considering that cities like Geelong, Bendigo, Wollongong and Tamworth also receive the regional 1 cent per litre subsidy with average September prices of 88.4, 93.3, 91.8 and 96.3 cents per litre respectively.

Regional Communities

An issue that has been an ongoing concern to the Queensland Government is the disparity between city and country fuel prices. Whilst it is acknowledged that market activities have more influence on prices in rural areas than taxes and transport costs, tax and subsidy regimes may provide the opportunities for prices in rural and remote areas to reduce the disparity between country and city prices.

The circumstances of people living in regional, rural and remote areas and the vast distances travelled by these consumers warrants special consideration. Generally, the market will determine the economic behaviour of consumers. However, there are areas where competition is non-existent particularly in remote parts of the State. The Fuel Sales Grants Scheme has set a precedent as it differentiates between non-metropolitan and remote zones. The Petrol Products Freight Subsidy provides assistance to people living in selected remote areas through subsidies to distributors for the cost of delivering fuel to those areas.

There has been a trend over recent years towards rationalisation of the number of service stations throughout Australia and there is a concern that service station closures in rural areas will have a further devastating effect on small country towns already suffering due to bank branch closures. The economic and social impacts of further closures on rural communities should be thoroughly assessed before any further reductions in services occur.

Competition is recognised as an essential element in reducing fuel prices and independent operators play an important role in this regard in the marketplace. The issue of taxation incentives to encourage new entrants into the market or to assist retention of services in country centres should be considered when the Inquiry examines the welfare of regional, rural and remote communities.