Office of the Minister of Energy and Resources
Office of the Associate Minister for Climate Change Issues

Chair, Cabinet Economic Growth and Infrastructure Committee

Expanding the purpose of existing energy levies to fund activities of the Energy Efficiency and Conservation Authority

Proposal

1 This paper seeks agreement to expand the purpose of three existing energy levies to enable the activities of the Energy Efficiency and Conservation Authority (EECA) to better align with changing government priorities.

Executive Summary

2 I propose to expand the purpose of existing energy levies to enable EECA to undertake a broader range of activities using levy funding. Levy funding will then be able to be used for any of EECA's activities to encourage, promote and support energy efficiency, energy conservation, and the use of renewable sources of energy (as per its statutory function[1]).

3 Electricity efficiency has been a major focus of EECA's activities as approximately half of its funding is recovered from a levy on electricity industry participants that is restricted to funding activities related to electricity efficiency.

4 While electricity efficiency is still important, the transport and industrial sectors are areas where the most impact can be made on improving New Zealand's energy productivity and reducing greenhouse gas emissions. This change in priority influenced my decision earlier this year[2] to refresh the New Zealand Energy Efficiency and Conservation Strategy 2011-16 (NZEECS) which drives EECA's work programme.

5 The changes proposed in this paper will complement the new NZEECS by providing EECA with greater flexibility to prioritise funding across its work programmes to better reflect changing government priorities in the energy and climate context. For example, the changes will enable EECA to levy fund the contestable fund I announced early this year to encourage the uptake of low emissions vehicles, such as electric vehicles.

6 There has been public consultation on options for expanding the purpose of existing energy levies. Submitters generally supported change and there was strong support to spread the cost of EECA's activities across multiple fuels. Submitters also favoured a transparent approach that broadly aligns activities with funding sources.

[1] Under the Energy Efficiency and Conservation Act 2000.
[2] I notified Cabinet of my decision in February 2016 [EGI-16-MIN-0012 refers].

Background

7 The Government has committed to the efficient use of energy and diverse resource development, including the development of our renewable energy resources and support of new technologies. These are key priorities in the New Zealand Energy Strategy (NZES) 2011-2021.

8 This is also a focus of the Natural Resource Sector (NRS) stream of the Business Growth Agenda (BGA) because improving energy efficiency and use of renewable energy can raise productivity, reduce emissions and promote consumer choice. This helps build a more competitive and productive economy for New Zealand.

9 In addition to the NZES and the BGA, the domestic and global energy environment has evolved significantly since the introduction of the NZES in 2011. For example, following the Conference of Parties 21 in Paris, New Zealand will also need to articulate domestic policies to support our transition to a lower emissions economy while increasing productivity, including in the energy sector.

10 EECA is the Crown Entity that works to encourage, promote and support energy efficiency, energy conservation and the use of renewable sources of energy. It is established under the Energy Efficiency and Conservation Act 2000 (the Act), which also sets out its functions and powers. In fulfilling its functions under the Act, EECA's programmes can decrease emissions, and complement other climate change measures such as the Emissions Trading Scheme.

11 EECA's current funding model means that almost half of its funding is recovered through a levy on electricity participants[3] that it is legally restricted to use for only electricity efficiency activities. The rest of its work is funded from general taxation (totalling $16.6 million in 2015/16). This proposal relates to EECA's levy funding only.

12 Electricity efficiency has been a major focus of the government's work, and good progress has been made. However, electricity only represents about 25 per cent of our energy demand, and produced six per cent of our total emissions in 2013, so there is limited scope for electricity efficiency measures to contribute to a reduction in overall emissions.

13 The areas where we can now have the most impact in emissions reduction are the transport sector where the use of non-renewable energy is the greatest, and the industrial sector where there is the potential for energy productivity improvements. Collectively energy emissions account for around 39 per cent of New Zealand's emissions. The industrial sector is also our highest user of energy, using 38 per cent of all energy in 2014, followed closely by transport at 36 per cent.

14 There is a huge opportunity to leverage off our renewables-based electricity system, especially to reduce emissions in the transport sector (which accounts for around 17 per cent of total emissions) by increasing our use of electric vehicles. The proportion of electricity generated from renewable sources continues to increase, reaching 81 per cent in 2015, whereas for transport the share of renewable energy is less than one per cent.

[3] Cabinet has approved up to $17.5m [Cab Min (07)12/1(56) refers], but to date EECA has only ever consulted on and drawn down $13m to fund its electricity efficiency work programme.

15 One example of how broadened levy funding could be used is the contestable fund that I recently announced to encourage the uptake of electric and other low emission vehicles (LEVs) [EGI-16-MIN-0069 refers]. This fund will be up to $6 million each year, which could come from expanded levy funding. Without change to the levy, there is a risk that opportunities like this in the transport sector, but also in the industrial sector, could be missed or not fully realised.

16 This need to change our priority in the energy sector influenced my decision earlier this year to replace the NZEECS, as noted by Cabinet in February [EGI-16-MIN-0012 refers]. The replacement NZEECS will be more relevant in the current energy policy context, and will focus EECA's work programme on activities that provide the greatest overall benefit to New Zealand.

17 Given the increased focus on our climate change commitments, I think it is timely to make changes to enable EECA's existing levy funding to be used for a broader range of activities, not just for electricity efficiency, and for an increased focus to be placed on reducing emissions. This would enable EECA to better prioritise its existing funding across its work programme and to reflect our priorities.

18 I sought Cabinet approval to release a discussion document on expanding the purpose of existing energy levies in May 2016, and agreed to report back to you in August with a preferred policy option [EGI-16-Min-0093 refers].

Options for consideration

19 The discussion document[4] proposed options for expanding the purpose of the following levies on the most consumed forms of energy in New Zealand, which are also the most relevant to EECA's activities. The options were:

19.1 the **electricity levy** on electricity industry participants that purchase electricity from the wholesale market (typically electricity retailers), which already funds EECA's electricity efficiency activities;

19.2 the Petroleum and Engine Fuel Monitoring Levy (**PEFML)**, which is a levy on importers of fuel (petrol, diesel, ethanol, and biodiesel) that currently funds fuel-quality and safety monitoring costs, and costs relating to our International Energy Agency obligations; and

19.3 the **gas levy** on piped natural gas[5] that funds gas safety activities.

20 I ruled out creating a new levy as a similar outcome can be more easily achieved by expanding one or more existing levies. I also ruled out the existing levy on coal under the Energy Resources Levy Act 1976 because it is not suitable for re-purposing, and coal supplies less than five per cent of New Zealand's total consumer energy demand. Further, 50 per cent of the coal we produce is exported while imported coal is not levied.

21 The discussion document presented the following options and assessed them against the objective of providing more flexibility in the allocation of existing funding and standard criteria for levy design (including causer or beneficiary pays, administrative simplicity and transparency/accountability):

[4] In formulating the discussion document, The Treasury's "Guidelines for Setting Charges in the Public Sector", December 2002 and the Controller and Auditor-General's "Charging fees for public sector goods and services", June 2008 were taken into account.
[5] Excluding gas sold for feedstock, for the generation of electricity or as LPG.

21.1 expanding the purpose of the existing electricity levy, with sub-options of revising the design to a rate per customer, or revising the design to a rate on electricity generated;

21.2 maintaining the existing electricity levy but also using the PEFML (with an expanded purpose), with the sub option of exempting biodiesel and ethanol; and

21.3 maintaining the existing electricity levy, but also using the PEFML and gas levy (with expanded purposes), with the sub option of expanding all three levies to create a pool of levy funds.

Comment

22 Twenty out of twenty six submitters were supportive of a change to levy funding. There was strong support to spread the cost of activities across electricity, transport fuels and gas[6]. A general theme in submissions was the importance of the levy being paid by the causers or beneficiaries of the activities undertaken by EECA.

23 In light of feedback, I propose to enable EECA to recover funding from all three levies. It is my intention to expand the purpose of each levy to enable the recovery of the costs of EECA's activities related to energy efficiency, energy conservation, and the use of renewable sources of energy. This will provide EECA with access to levy funding for activities that meet its statutory function.

24 My proposal will give EECA greater operational flexibility, but I propose to put in place requirements to balance this with the need for transparency and accountability. This was a theme that submitters raised, and I believe I have struck the right balance in response.

25 The proposed approach has the advantage of being simpler to administer than alternatives. EECA will have to justify how and why it will use levy money for a particular activity (through consultation described below and reporting), but it will avoid the complexity of making strict judgements about which levy can be used when a programme cuts across multiple fuel types. Under the other multi-fuel option I considered, EECA would have had a statutory obligation to link each of its activities to the particular fuel being levied (as it currently does for the electricity levy). An appropriate level of transparency and accountability can instead be achieved by implementing enhanced consultation and reporting requirements.

26 I propose that EECA should be required to demonstrate in detail, and seek feedback on, the link between its proposed work programme and levy payers to inform the proportion of funding to be raised from each of the three levies.

27 I propose that each year EECA set out, and seek feedback on:

27.1 the programmes it intends to initiate or continue from previous years;

27.2 who it intends to target with these programmes, and the outcomes they propose to achieve through those programmes;

27.3 the link between those groups being levied and whether they are either the beneficiaries, or the 'causers' of the need for the programme; and

[6] Of twenty submissions that supported the proposal, seventeen supported options that spread the cost of the levy across these fuels.

27.4 the total levy funding proposed and the proposed proportion of that funding that will come from each of the three fuel types.

28 Under this approach, EECA must describe the fuel types it is intending to levy for that year and demonstrate a logical link between its specific programmes and the levy or levies. This will require it to identify for programmes where levy funding is proposed to be used, which levy (or levies) will be contributing funding and by how much.

29 For example, if EECA proposes to use levy funding for activities to improve the efficient use of gas, such as upgrading gas boilers, it will need to indicate how much of this funding it proposes to recover from the gas levy.

30 There will be instances where allocation of funding is complex, such as programmes that can be logically linked to multiple fuels. The changes allow EECA the flexibility to fund such programmes from two or three of the levy funding sources, provided that EECA can demonstrate how it links to each levy. The practical advantage of this approach would be that EECA could, for example, fund the LEV contestable fund from a combination of the PEFML and the electricity levy. However, EECA would still need to justify this and be transparent with stakeholders that they are attributing some cost to electricity levy payers because they are beneficiaries of the programme, and PEFML levy payers as they are the causers.

31 I believe that the strong and clear expectation that this approach places on EECA will deliver an appropriate level of transparency and accountability, while avoiding the practical challenge of a statutory obligation that limits programme funding to a particular fuel being levied.

32 The procedure for consultation and setting the rates and allocations would be similar to the current requirements for the electricity levy[7]. It will involve EECA preparing a draft work programme showing where funding for each of the programmes is proposed to be recovered from, and proposing corresponding total levy amounts and proportions for consultation with levy payers.

33 EECA will then report to me on the outcome of that consultation. I will then make final decisions on levy funding for the following year.

34 I propose that this consultation is undertaken every year. I expect the relative contributions of each levy to change over time as EECA's work programme adjusts to reflect changing priorities in the energy sector. I also expect EECA to report on and publish its work programme every year, including how levy funding was allocated.

35 To enable a smooth transition to the new levy arrangements, I propose setting the initial allocation for 2017/18 at: 40 per cent from the electricity levy, 50 per cent from the PEFML, and 10 per cent from the gas levy. This differs slightly from the allocation proposed in the discussion document of 30 per cent from electricity, 50 per cent from PEFML and 20 per cent from gas, which aligned with energy use. However, it more closely aligns with EECA's indicative work programme for next year. The new consultation requirement will then apply to levy funding from 1 July 2018 and out-years.

36 I also propose that the electricity levy is aligned with the other levies to allow the levy to be adjusted in out-years to account for any underspend rather than requiring money to

[7] Under section 129 of the Electricity Industry Act 2010.

be refunded annually. This is consistent with the current approach to multi-category appropriations.

37 This approach gives EECA flexibility without making the operation of the levy too complicated. Broadly aligning the relative contributions of each of the three levies to EECA's work programme, and the consultation and reporting requirements, will ensure transparency, accountability and efficiency, while minimising administrative complexity and costs.

Impacts on consumers and businesses

38 While each of the three levies is collected from suppliers, the cost of the levy is ultimately passed on to consumers and businesses (through their electricity and gas bills, and petrol or diesel at the pump). The proposed changes will, therefore, impact on consumers. The amount collected through the electricity levy will reduce, while amounts collected through the PEFML and gas levy will increase.

39 Table one below sets out an indicative impact, assuming EECA recovers a total of $13 million, and 40 per cent is from the electricity levy, 50 per cent is from the PEFML, and 10 percent is from gas levy[8] (which is the proposed transition allocation for 2017/18). The net impact on households will be an increase of $1.60 per year, and the net impact on businesses will be a reduction of $1.5m per year.

Table one: indicative impact on consumers and businesses[9]

Levy	Status quo	With proposed expansion
Electricity levy		
Purpose	Fund EECA's electricity efficiency activities (the Electricity Levy also recovers the costs of operating the Electricity Authority).	Fund EECA's activities
Cost to households	$2.33 per year on average	93 cents per year on average, which is a reduction of $1.40
Cost to businesses	About $9m per year in total	About $4m per year in total, which is a reduction of $5m
PEFML		
Purpose	Fund fuel quality and safety monitoring costs, and costs related to our International Energy Agency obligations	Fund fuel quality and safety monitoring costs, costs related to our International Energy Agency obligations, and EECA's activities
Cost to households	$3.79 per year on average	$5.69 per year on average, which is an increase of $1.90 per year

[8] This is the amount EECA has recovered from its electricity efficiency levy appropriation each year over the past five years. Impacts will change if the total funding proposed to be recovered by levies is increased, or if proportions are adjusted.

[9] Figures for businesses are presented as the total amount payable because the amount each business pays will vary substantially based on the amount of electricity, fuel or gas they use. For example, a transport company that uses high volumes of fuel will pay more PEFML than a business with a single van, such as an electrician.

Levy	Status quo	With proposed expansion
Cost to businesses	About $6m per year in total	About $9m per year in total, which is an increase of $3m
Gas levy		
Purpose	Fund gas safety activities	Fund gas safety activities and EECA's activities
Cost to households	55 cents per year on average if use reticulated natural gas	$1.65 per year on average, which is an increase of $1.10 per year
Cost to businesses	About $0.5m per year in total.	Will pay about $1.5m, which is an increase of $1m.
Net impact on households		**$1.60 increase**
Net impact on businesses		**$1.5m decrease**

Consultation

40 There has been public consultation on the proposed changes. The following departments have been consulted on the development of this paper and associated Regulatory Impact Statement; The Treasury, Ministry of Transport, Ministry for the Environment, the Energy Efficiency and Conservation Authority and the New Zealand Customs Service. The Department of Prime Minister and Cabinet has been informed.

Financial Implications

41 There are no financial implications for the Crown from the proposals. The proposal provides an alternative method to recover a similar level of funding using existing levies.

42 It will be necessary to make administrative changes to the 2017 Budget Estimates of Appropriations for out-years from 1 July 2017, and further advice will be provided for agreement by the Ministers of Finance and Energy and Resources later in 2016.

Human Rights

43 There are no human rights issues associated with the proposals in the discussion document.

Legislative Implications

44 The electricity levy is provided for in the Electricity Industry Act 2010, and the Electricity Industry (Levy of Industry Participants) Regulations 2010 prescribe how it is calculated and administered.

45 The gas levy is provided for and set in the Energy (Fuels, Levies and References) Act 1989. The PEFML is provided for in the same Act, but the rate is set in the Energy (Petroleum or Engine Fuel Monitoring Levy) Regulations 2015.

46 The Acts will require amendment and I plan to include them in the Energy Innovation (Electric Vehicles and Other Matters) Bill [redacted]. The Bill is intended for introduction later in the year.

47 The associated regulations (referred to above) will also require amendment and I will seek Cabinet agreement to amendment regulations to enable the new arrangements to commence from 1 July 2017.

Regulatory Impact Analysis

48 The Regulatory Impact Analysis requirements apply to this policy process. A Regulatory Impact Statement has been prepared by the Ministry and is provided with this Cabinet paper.

Quality of Impact Analysis

49 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.

Publicity

50 I intend to make a media statement on these decisions. This paper and the Regulatory Impact Statement will be made available on the Ministry of Business Innovation and Employment website following that. Key stakeholders will be notified of its content and release.

Recommendations

It is recommended that the Committee:

1 **Note** that there is a growing need to give more focus to the transport and the industrial sectors to meet our broader objectives of efficient use of energy and diverse resource development, including developing our renewable energy resources and supporting new technologies, which contribute to meeting our climate change objectives;

2 **Note** that the Energy Efficiency and Conservation Authority (EECA) is the government agency responsible for undertaking activities that encourage, promote and support energy efficiency, energy conservation and the use of renewable sources of energy;

3 **Note** that I am proposing changes that will provide EECA with greater flexibility to prioritise its funding to better align with Government objectives, and direct its funding to activities with the greatest impact;

4 **Note** that there has been public consultation on the proposed changes and there was strong support for levying electricity, transport fuels and gas, with submitters favouring a transparent approach that broadly aligns activities with funding sources;

5 **Agree** to expand the purpose of the following levies to enable the costs of EECA's activities relating to energy efficiency, energy conservation, and the use of renewable sources to be recovered from them:

5.1 the electricity levy, as provided for in the Electricity Industry Act 2010 and the associated regulations; and

5.2 the Petroleum and Engine Fuels Monitoring Levy (PEFML) and gas levy, as provided for in the Energy (Fuels, Levies and References) Act 1989 and the associated regulations;

6 **Agree** to the expanded levies initially being recovered at the following rates: 40 per cent from the electricity levy, 50 per cent from the PEFML, and 10 percent from the gas levy for the 2017/18 year (as a transition year);

7 **Note** that the policy changes will be reflected in the 2017 Budget Estimates of Appropriations for out-years from 1 July 2017;

8 **Agree** that the electricity levy is aligned with the other levies to allow the levy to be adjusted in out-years to account for any underspend rather than requiring money to be refunded annually to be consistent with the current approach to multi-category appropriations;

9 **Agree** that the Ministers of Finance and Energy and Resources will approve the changes for inclusion in 2017 Budget Estimates of Appropriations;

10 **Agree** that EECA will consult on a draft work programme and the levy rates and proportions each levy will contribute to the levy funding every year, to ensure the proportions are in line with the work programme, beginning with consultation for funding from 1 July 2018 and out-years;

11 **Agree** that this consultation will include the following:

11.1 an obligation to consult with levy payers of all three levies every year;

11.2 that consultation will include:

11.2.1 its draft work programme for the following year including;

11.2.2 the programmes it intends to initiate or continue from previous years;

11.2.3 who it intends to target with these programmes, and the outcomes they propose to achieve through those programmes;

11.2.4 the link between those groups being levied and whether they are either the beneficiaries, or the 'causers' of the need for the programme;

11.2.5 where funding for each of the programmes is proposed to be recovered from;

11.2.6 the total amount of levy funding it proposes using over the year; and

11.2.7 the proposed proportion of levy funding that will come from each of the levies;

11.3 Following this consultation, EECA will make a recommendation to the Minister of Energy and Resources on its work programme and levy funding proposal:

11.3.1 The Minister of Energy and Resources will make final decisions on the levy funding recommendation; and

11.3.2 EECA will report on and publish its work programme annually, including how levy funding was allocated;

12 **Note** that the indicative net impact of this change on consumers in 2017/18 (assuming EECA uses $13 million of levy funding) will be an increase of $1.60 per year on households, and a reduction of $1.5m per year on businesses;

Legislation

13 **Invite** the Minister of Energy and Resources to issue drafting instructions to the Parliamentary Counsel Office to give effect to these recommendations; and

14 **Authorise** the Minister of Energy and Resources to make decisions consistent with the overall policy decisions in this paper on any minor and technical issues that may arise in the drafting process.

Authorised for lodgement

Hon Simon Bridges

Minister of Energy and Resources

Associate Minister for Climate Change Issues