

Australian Greenhouse Office and Environment Australia Response to the Productivity Commission Position Paper, 'Review of automotive assistance' (June 2002)

The AGO and Environment Australia commend the Commission for completing this significant work within a short period of time. It is pleasing to see that the Commission (pages XXII, 65, 67, 68) and the industry (page 65) agree that environmental issues are placing commercial pressure on motor vehicle producers to improve their products. The Commission also acknowledges the link between industry policy and environmental impacts (page 72). The AGO and Environment Australia therefore welcome the Commission's Position Paper 'Review of Automotive Assistance'.

This response focuses only on those areas of the report where the AGO/EA consider the Commission might benefit from reconsidering the issues raised. In particular regarding the importance of environmental impacts, the positioning of the role of policies impacting environmental performance and the discussion of fuel consumption targets and government purchasing.

The AGO/EA also identifies areas of the report where there is the need for a revised fact base.

Environmental impacts are a major issue

The environmental impact of the automotive industry is a 'major issue relevant to the industry's role and future' (page VII). The Commission has flagged that environmental issues will receive greater treatment in the final paper, but the AGO/EA recommend that the Commission explicitly factor these issues into any evaluation of the impact of assistance arrangements or other policy initiatives in the automotive sector.

For example:

- **On page XV The Commission states that Governments objectives for the automotive industry ... 'should not be detrimental to the interests of the community as a whole'**

The AGO/EA suggest that it would be relevant to mention the environmental and safety aspects, relevant to the community as a whole, that are linked to the assistance mechanisms.

- **On page 1 the terms of reference for the inquiry require the Commission to have regard to the desire 'to improve the overall economic performance of the Australian economy'.**

Economic impacts are about welfare. As the Commission itself states, on page 107, the terms of reference seek to 'encapsulate all dimensions which bear on the welfare of the Australian community'.

GDP and other similar indicators are only approximate measures for welfare. Welfare also includes the quality of the environment and the health and safety of our community. A more complete discussion of these contributors to economic welfare, an assessment of the impacts of assistance arrangements on them, along with an acknowledgment of the limitations of the existing models in reflecting these aspects would be welcome.

- **On page XXI The Commission acknowledges that ‘there are costs imposed on others in the community’**

It would be relevant to mention the additional externalities imposed on the community in the form greenhouse gas and air pollution emissions that are linked to the assistance mechanisms.

The role of policies that encourage improved environmental and safety performance

The report contains some inconsistency regarding the need to encourage the Australian industry to improve the environmental performance of their products. For example the Commission notes (page 65) that ‘demand by consumers for safer and cleaner vehicles and for improved environmental outcomes more generally, will also be a fundamental driver of change. Indeed, in many respects, more stringent standards have mirrored, rather than led, developments in the automotive market. ... These pressures for change are intensifying, with major developments in vehicle technology in train or in prospect to accommodate them. Effective responses to these pressures and developments will be an imperative for the Australian automotive industry if it is to continue to be a viable player in the global industry... There is no demur from the industry on this matter.’

Given this context, the AGO/EA suggest that the Commission review their positioning of the following issues.

- **Page 38 The Commission considers ‘Ways to ensure that safety and environmental policies do not unnecessarily or inadvertently impede the industry’s future development’**

The AGO/EA request that the Commission provide some evidence to support the negative implication of this statement. Environmental policies are developed with industry consultation, and are often voluntary. Emission standards are an example of Government working to provide significant time for industry to adjust.

By contrast, the Commission’s assessment of assistance to support the automotive industry has not incorporated environmental externalities. It would, perhaps, be more relevant to refer to ‘ways to ensure that industry assistance arrangements do not unnecessarily or inadvertently impede improvement in environmental amenity for Australia, or detract from the competitiveness of Australian automotive products by limiting advances in technology that improve environmental and safety performance’.

- **Pages 66 and 137 The Commission ‘has argued that changes to environmental policies impinging on the industry should have regard to the capacity of the firms and the industry to make the necessary changes.’**

The AGO/EA request that the Commission provide evidence to support the inference that development of environmental policy does not have regard to the capacity of firms to make the necessary changes. Alternative wording might be that ‘changes to environmental policies relating to the automotive industry, continue the established practice of including regard to the capacity of the firms and the industry to make the necessary changes’.

- **On page 70 the Commission states that ‘Delay of regulation won’t prevent upgrading to meet global markets’.** Delay of regulation in Australia is, however, likely to mean that vehicles sold in Australia will not meet these standards. Given that the domestic market is, and appears likely to remain, the largest market segment for domestic manufacturers, the Australian standards are likely to be the benchmark to which our vehicles are built. Once again, the argument on this point is about externalities in the way of air pollutants faced by the Australian community.
- **On page 75 the Commission notes that ‘With the industry’s viability heavily tied to exports, ready access to overseas markets is clearly very important’.** The Commission may wish to consider raising issues such as fuel consumption targets and recycling targets (for example the End of Life Vehicle Directive in Europe), which may also become non-tariff barriers to trade in the future.
- **On page 129 The Commission states it ‘does not consider that using ACIS as a means of achieving broader goals - such as environmental or industrial relations outcomes - is desirable’.**

As the Commission has noted, environmental performance of automotive products is directly relevant to the long-term viability of the industry in Australia. ACIS should be structured to ensure long-term viability. Environmental outcomes can therefore be relevant to consideration of how to structure ACIS.

There are a number of areas the Commission needs to clarify in chapter 7.

- **Page 66 ‘at the same time, it is important that such policies are set to achieve specified safety and environmental goals. While there may sometimes be an indirect benefit for the local industry, environmental and safety policies should not be formulated explicitly for this purpose’.**

AGO/EA suggest the following ‘Safety and environmental policies should be formulated to achieve their specific goals in the most efficient manner. The benefits for the local industry that can result from these policies add to their value to the community, but are not the primary objective’.

- **Page 73 Section titled ‘But their impact on vehicle safety or the environment should be the key consideration’**

This section might better be titled ‘Environmental and safety benefits can complement industry policy’.

AGO/EA suggest the wording of the section requires clarification.

AGO/EA do not wish to express a particular view on this issue, but the Commission may wish to consider the following as alternative wording to express its point:

‘Environmental and safety benefits can strengthen the case for particular industry policy changes. For example, potential environmental and safety benefits reinforce the policy argument for aligning tariffs on passenger and 4WD vehicles. Similarly, environmental policies will sometimes be reinforced by benefits to the industry. For example, encouraging environmental management systems also saves costs for the industry through waste reduction.

However, it is not always the case that a recommended policy change will meet the objectives of improved environmental and safety performance and the

objective of providing industry protection. Finding policies that meet both objectives efficiently is difficult. It is important to find the balance that maximises Australia's welfare and to recognise both sets of objectives when evaluating the outcome of any proposed policy change.'

- **(Page 68) that 'fuel standards in Australia are potentially detracting from the future viability of the automotive industry'.**

The Commission may wish to clarify if the implication is that to be viable, the Australian manufacturers will have to introduce new, more fuel efficient, engine technologies and clarify the timeframe they are considering.

Fuel consumption targets

The Commission may wish to review its discussion of this issue.

- **Page XXXVI 'Fuel consumption targets should take account of customers willingness to pay'**

Fuel consumption targets are tools. They aim to internalise externality costs associated with fuel consumption. The AGO has provided evidence to the Commission of the significant environmental externalities associated with motor vehicles and some indicators of the magnitude cost (see box below). Basic economic theory explains that customers are generally 'unwilling' to pay for the costs they impose on other people through externalities. It is a classic 'market failure' and one that under standard economic theory requires government intervention to resolve. The current Government prefers a light-handed approach to regulation and is willing to work with industry to set voluntary targets. The targets must, however, achieve the objective of reducing the externality or they have no value to the community. Since there are no penalties associated with failure to meet the targets, it is reasonable to ask the industry to set challenging targets for themselves.

It is a second order issue from an environmental perspective that consumers are gradually showing more willingness to internalise these kinds of costs and are starting to demand vehicles that perform better. Preferences have not yet moved to the point that externalities have been fully internalised.

(AGO/EA submission pages 7 and 8) It is difficult to place a value on the impact of environmental externalities. However, it is possible to provide some indicative costs to understand the order of magnitude of the impacts.

In the context of improvements in fuel quality standards and tighter vehicle emission standards, the Environmental Economics Unit of Environment Australia estimated that from 2000 to 2019, avoided health costs from reduced levels of CO, hydrocarbon and particulate emissions, will amount to greater than \$3.4 billion (Regulatory Impact Statement for the Fuel Quality Standards Bill 2000). ...These estimates are based only on direct health costs, such as hospitalisation.

Modeled estimates of the cost of greenhouse gas emission reduction range from \$5 to \$34 per tonne of CO₂-e (AGO, 1999). If the \$5 per tonne estimate were used as a proxy for impact costs, it would suggest that the cost of abatement to offset the additional greenhouse gas emissions from the transport sector since 1990 might be in the order of \$150 million per annum. It should be noted that this is based on estimated costs of abatement, rather than impact costs.

- **On page 71 the Commission refers to ‘shortcomings of average fuel consumption targets’**

A more specific and balanced evaluation, taking into account issues of practicality and feasibility of options, would be appropriate. Certainly there are free rider problems with creating a national rather than corporate average fuel consumption target, which could usefully be explored by the Commission. It is also true that fuel taxation would be a more direct option for targeting fuel consumption, but recommended actions must be realistic and the level of price change required to induce a behavioural change needs to be considered. It would be useful if the Commission could illuminate some of the valid ways in which a fuel consumption target can be used to achieve results and how they have been successful in doing so internationally.

The AGO/EA submission (page 10) provides the following examples:

- *The European Commission (EC) and the European Automobile Manufacturers Associations (ACEA) agreed, in July 1998, a voluntary average fuel consumption target that represents 140g CO₂/km in 2008. The target of 140g CO₂/km represents fuel consumption of 6.0 (petrol) or 5.3 (diesel) litres per 100km and is an improvement of 25 per cent over a 13-year period ... The ACEA agreement is already producing credible results with the average CO₂ emissions of new cars reduced from the 186g CO₂/km 1995 baseline to 174g CO₂/km in 1999. The CO₂ performance is consistent with achieving the 2008 commitment of 140g CO₂/km.*

(Note that in a press release on July 9, 2002 ACEA announced they have reached 164g/km below the 2003 target range of 165 - 170 g/km; ACEA and Chairman of the Managing Board of PSA Peugeot Citroën, said: "These results are encouraging and show that the European automotive industry is continuing to deliver what it has agreed")

- *The California Air Resources Board (CARB) program requires that 10 per cent of vehicle sales should comprise zero emission vehicles (ZEVs) by 2003. Partial ZEV ‘credits’ will be available for ‘super-ultra-low emission vehicles’ (SULEVs). Fuel cell and electric-hybrid vehicles may qualify for this category (OECD, 2000). Low emission vehicles can receive a tax credit of between US\$1,000 and \$4,000 over the period 2002-2006.*

Government purchasing

The Commission's recommendations on Government purchasing could be reviewed to be consistent with the discussion in the report and with other recommendations. For example

- The Commission states (page XXXIV) that 'Government purchasing preferences for vehicles manufactured or imported by the local producers would have no place in a free and open market'. In addition, (page 131) the Commission notes that 'the preferences are potentially in breach of the WTO agreement on government procurement'.
- The Commission also recommends greater transparency of support provided to the industry (page 131-132) and acknowledges the cost of the Commonwealth purchasing arrangements is unknown (page 131¹) and that State and local governments replicate these preferences, which extends the possible impacts (page 95).
- The Commission also refers to the expectation that the tariff-ACIS combination should represent the 'totality of industry support' (page 122) and that (page XXIII) 'indefinite preferment of the industry is not warranted'.

Given this discussion the Commission might wish to consider providing some guidance as to the appropriate timing for changing the current government purchasing arrangements.

Since the Commission discusses the issue of government purchasing, it may also wish to give consideration to the possibility of creating some additional flexibility in the purchasing arrangements to allow for vehicles with superior environmental performance to balance the environmental impact on the community of the current recommendation.

Comments on points of fact

1. On page 70, the Commission states that the current National Average Fuel Consumption (NAFC) target is 8.3 litres per 100km.

8.3 L/100km has never been a 'target'. The most recent target set by the industry was 8.2 L/100km by 2000. The actual rate of NAFC achieved for 2000 was 8.34 L/100km (ie the industry missed the target by 1.7% or by around a year and a half based on historic rates of improvement).

There is currently no agreed target for any future year. The offer from industry stands as 7.4 L/100km for 2010, with the 'cooperative' target of 6.8 L/100km by 2010 and 6.3L/100km by 2015 subject to a strong conditionality (reproduced in box 7.1).

2. On page 71 the Commission states that comparisons of average fuel economy are of limited relevance.

The main comparison we seek to draw in this context is the rate of improvement in fuel consumption, rather than the absolute level. Europe has targeted a 25 per cent improvement in fuel consumption over a 13-year period. The proposed target of

¹ Costs ... *could* be relatively small.

6.3 L/100km by 2010 would also represent a 25 per cent improvement in fuel consumption over a 13-year period, thereby keeping pace with improvements in Europe.

There are valid arguments as to why we might not see the Australian NAFC catch up in absolute terms to European levels, but the point is that achieving a NAFC of 7.4 L/100km by 2010 would see us fall further behind. Although the quote (page 71) correctly states the AGO's assessment of the lag in time to Europe, the AGO would prefer the Commission refer to the rate of change comparison.

Page 19 of the AGO/EA submission reads:

"In this context, the target of 15 per cent below BAU translates to 6.3 litres per 100km. To move from current fuel consumption rates to 6.3 litres per 100km by 2010, is in line with the rate of improvement expected in Europe, that is a 25 per cent reduction in the average fuel consumption of new vehicles over a 13-year period (1995-2008 for the EU and 1997-2010 for Australia)."

3. On page 71 and again on page 73 the Commission refers to possibility that the use of smaller vehicles for environmental reasons might have adverse safety implications.

If the Commission wishes to examine safety impacts of changing the types of vehicles used in Australia, it should present a balanced view. Larger cars can also be 'unsafe'. For example, Australian Transport Safety Bureau (ATSB) has recently published statistics on four-wheel-drives indicating that increased number of 4WDs is having a significant impact on road safety. Between 1990 and 1998, fatal 4WD crashes increased from 101 to 187 and the number of fatal crashes involving 4WDs increased from 123 to 212 (72%) over the same period. The rate of 4WDs involved in fatal crashes is higher than the rate for passenger cars (Press Release from Senator Boswell 14 March 2002). AGO has previously provided the supporting press release and other material related to this topic to the Productivity Commission.

The Australian New Car Assessment Program (ANCAP) gives consumers consistent information on the occupant protection levels of vehicles involved in severe crashes². ANCAP state that 'occupants of heavier vehicles in real-world two-vehicle crashes typically fare better than people in lighter vehicles.' However, ANCAP indicate that rather than comparisons of vehicle size, it is the features and quality of the vehicle that should be compared 'in many single-vehicle crashes, weight offers no safety advantage. This is why crash test results shouldn't be compared among vehicles with large weight differences. Typically, a driver's airbag reduces the risk of serious head injury by half.' Many small cars are now being designed to meet 4 stars on the ANCAP rating system although there are some models where the risk of injury is still high³.

4. On pages 35 and 70 the Commission state that lower fuel quality standards in Australia could conceivably hinder the uptake of new engine technologies

The Commission needs to acknowledge that there are types of improved engine and emission technologies for spark ignition engines that can be introduced within current

² http://www.nrma.com.au/Page/Public?PageId=mot_ct_about_ancap

³ October 12 2001. www.aaa.asn.au/press/2001/12-10.htm 'Crash testing shows improvements in Australian small car safety standards'.

petrol standards. For example, exhaust gas oxygen (EGO) sensors, exhaust gas recirculation, multi-point fuel injection, sequential fuel injection, and variable valve timing/lift.

Other issues

Page 125 Discount rates.

To avoid disagreement later, the Commission needs to provide the discount rate assumptions for the calculation of annual payments that would reach the same NPV in 2005 for the three ACIS options.

Page 97 Non-tariff assistance

Please clarify that this does not include the value of Government purchasing preferences, or estimate the value of these sales and add them to the estimate.

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