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Department of Infrastructure, Transport, Regional Development, Communications and the Arts

AI GROUP RESPONSE TO THE FUEL EFFICIENCY STANDARD CONSULTATION PAPER

The Australian Industry Group (Ai Group) welcomes the chance to make a submission on the Fuel Efficiency Standard Consultation Paper (the Paper).

Ai Group is a peak national employer organisation representing traditional, innovative and emerging industry sectors. We have been acting on behalf of businesses across Australia for nearly 150 years. Ai Group is genuinely representative of Australian industry. Together with partner organisations we represent the interests of more than 60,000 businesses employing more than 1 million staff. Our members are small and large businesses in sectors including manufacturing, construction, engineering, transport & logistics, labour hire, mining services, waste services, the defence industry, retail, aged care, civil airlines and ICT.

Our members include many businesses that would be impacted by the proposed standard, including light and heavy vehicle manufacturers, wholesalers, and retailers; vehicle parts manufacturers; energy businesses; fleet operators; and vehicle battery manufacturers and wholesalers.

Our attached submission addresses many critical issues raised by the Paper.

For any questions in relation to this submission, please contact ██████████
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Sincerely yours,

Louise McGrath
Head of Industry Development & Policy

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General questions

Principles for Setting a Fuel Efficiency Standard

Are these the right guiding principles? Are there other principles that you think we should keep in mind?

Ai Group is supportive of the guiding principles proposed in the discussion paper. However, we would like to highlight that a clear statement on the relationship between this measure (and the related emissions reduction) and the national net zero targets should be part of the guiding principles, as the success of this measure will impact the emissions budget available to other sectors.

Design Assumptions

Are there any design assumptions that you think will put at risk the implementation of a good FES for Australia? Are the exclusions for military, law enforcement, emergency services, agricultural equipment and motorcycles the right ones?

Ai Group is generally supportive of the design assumptions. We would like more detail on the vehicles included in the proposed exclusion, and how these exclusions would be applied in practice to vehicles within named fleets that are not modified for specific uses.

FES Design Features

The average annual emissions ceiling

What principles should we consider when setting the targets?

The general guiding principles proposed for the scheme are also relevant to the setting of targets, but will need to be more specific to be actionable.

Scheme settings will need to achieve goals for emissions, equity, transparency, credibility and enablement of vehicles that meet Australian consumers' needs.

A meaningful and binding emissions reduction target will assist vehicle manufacturers and importers to secure greater supply of vehicles from their global production volumes. The lack of such targets over recent years has had a negative impact on vehicle supply to the Australian market, vis-à-vis other markets globally with a binding target.

With respect to broader economy-wide emissions, the Government will need to consider the specific quantitative goals for greenhouse gas emissions reduction that it has committed to, and will update in future, under the Paris Agreement. These goals include both point targets (currently 43% below 2005 levels by 2030 and net zero by 2050) and, crucially, carbon budgets (currently 4,381 million tonnes CO₂ equivalent 2021-30). We understand the Government will develop a new Paris commitment extending to 2035 by the end of 2025.

Light transport covered by the proposed FES will need to contribute towards these specific goals. How much contribution is warranted? The Government has already taken the view that the industrial, resources and heavy transport facilities covered by the Safeguard Mechanism should make a reduction from 2020 to 2030 that maintains their 2020 share of national emissions as national emissions fall by 43% from 2005 levels. In the context of the Safeguard entities, whose collective emissions grew substantially between 2005 and 2020, that is less challenging than a 43% cut from 2005 levels would be. This requires that other sectors cut by more than 43% in order to achieve the economy wide goal. Electricity generation and land use will substantially outperform this metric, but even so there appears little room for other sectors to underperform it without either ramping up already-determined emissions policies or risking the overall emissions targets.

The long lifetimes of registered motor vehicles and slow turnover of the total fleet are another complicator to ambition and emissions burden-sharing. Fleet emissions are only very gradually shaped by the performance of new vehicles. If the rate of turnover remains roughly stable at around 5% per annum, even fairly aggressive

standards for new vehicles will take considerable time to build up to large impacts on overall fleet-wide light vehicle emissions.

For instance, suppose a simple but aggressive hypothetical standard led to 15% ZEV sales in 2026 to 100% ZEV sales in 2035, without changes to the efficiency of conventional vehicles. Sectoral emissions in 2035 might fall by only around a third from their current levels, and hit net zero in the late 2040s.

On the other hand, the rate of turnover of vehicles might increase, whether as a result of policy, such as tax incentives for the early replacement of higher-emitting vehicles, or of network effects and market dynamics, such as the probability that ZEV take-up gradually reduces the viability and hence availability of petrol and diesel refuelling and servicing capacity. Combining the same hypothetical aggressive standards with a ramp-up to double the pace of sales, starting once ZEVs account for at least half of new vehicle sales, might see total reductions of around 40-50% from current levels by 2035 and net zero in the early 2040s.

The Government will need to think deeply about the dynamics of fleet turnover and whether there are light transport-relevant instruments beyond the FES that should be taken into account in setting scheme targets. In this, it is important that such measures avoid unnecessary distortions to the market that could dis-incentivise vehicle manufacturers from bringing certain technologies to the Australian market. More broadly, incentives should be technology agnostic to avoid 'picking winners' of one low emissions platform over another. This principle will also be important in attracting a mix of technologies to help decarbonise heavy transport across Australia.

The emissions principle should therefore be that FES targets contribute to the achievement of Australia's economy wide climate goals, proportionately to light vehicles' share of national emissions in 2005. Given the sectoral challenge of fleet turnover, this contribution should be pitched against Australia's total carbon budget under the Paris temperature goals. That would account for the likely dynamic that sectoral reductions are weaker than the economy-wide point targets for 2030 and 2035, but hit net zero earlier than the economy as a whole.

What should Australia's CO2 FES targets be?

In light of the above proposed principle, it is relevant to note the targets emerging from the United States, which has comparable overall emissions ambitions to Australia, and from Europe, which has higher ambitions in some ways. The revised standards proposed, but not yet locked in, by the US Environmental Protection Agency appear challenging but these and other initiatives are likely to reshape the global automotive industry. The technologies available to markets like Australia will be transformed, given adequate notice to suppliers of our national requirements.

We also note that these overseas targets are part of a wider policy suite including major investments in supporting infrastructure and the provision of strong economic incentives, including tax credits for ZEVs in the United States and a second Emissions Trading Scheme covering road transport fuels in the EU. In Australia, the feasibility of ambitious FES targets will be enhanced by comparable levels of infrastructure provision and uptake support. The investment in infrastructure will have broader benefits – including assisting the decarbonisation of heavy road transport vehicles.

Should the Australian FES start slow with a strong finish, start strong, or be a straight line or take a different approach?

The trajectory of the FES needs to take account of the lag, discussed above, between new vehicle fleet composition and total vehicle fleet performance, and consider the total contribution towards Australia's carbon budgets that is achieved. A series of gentle targets leading up to a rapid-decline 'strong finish' may entail a budget-busting level of overall emissions, with legacy ICE vehicles taking perhaps 20 years to exit the fleet. Therefore, the difference between the strength and trajectory of targets, and the strength and trajectory of overall emissions outcomes, should be kept firmly in mind.

Australia has not yet adopted a comprehensive carbon budget towards its long-term climate goals. The emissions reduction target for 2035, expected to be adopted by the end of 2025, is likely to be a much larger number than the existing 2030 target in order to contribute to the Paris temperature goals. The likelihood is that long term goals will keep evolving along with successive mid-term goals. For example, the state of Victoria has recently adopted a 2035 emissions target (75-80% below 2005) that is substantially more

ambitious than its 2030 target (45-50% below 2005) and brought forward its net zero goal from 2050 to 2045. New, and future, zero emissions technologies will need to play a key role in enabling governments and industry to meet these ambitious mid-term targets.

An additional factor to consider is the consequences of slow pathways to emissions reductions. While in a budget approach shallower early reductions can be partially balanced by steeper later reductions, if left too late – or subject to significant lags, as fleet emissions are – the necessary rate of reduction in emissions may become unfeasible or simply impossible. That would leave three options:

- greater rates of reduction for other sectors of the economy, which will have costs and challenges of their own;
- missing Australia’s commitments and accepting the diplomatic and climate consequences of doing so; or
- increasing Australia’s reliance on negative emissions technologies, and on net negative economy-wide emissions following net zero. Negative emissions are possible through both nature-based and engineered processes, and are already required to balance irreducible residual emissions in net zero pathways. Global net negative emissions are now required to some extent in almost all modellable scenarios that keep global temperature increases to around 1.5C. But physical constraints and substantial economic costs mean that excessive reliance on negative emissions could be infeasible and would certainly be very burdensome.

In other words, any of the above options would involve significant costs and risks to balance against the costs and risks of a given FES target trajectory.

The combination of the above factors makes trajectory setting for the FES very challenging. Decisions will best be made on the basis of long-term carbon budget guidance; that guidance will initially be lacking; and waiting for fuller guidance would entail lags in outcomes that would guarantee higher overall economic costs and risks. It appears that a ‘strong finish’ trajectory is very unlikely to be optimal in these circumstances. A ‘strong start’, within the limits of feasibility implied by vehicle sector supply chain adjustment times, may be most sensible. Any trajectory should be adopted with explicit recognition of the expected emissions it implies and the likely range of carbon budgets over the next several decades.

How many years ahead should the Government set emissions targets, and with what review mechanism to set limits for the following period?

There are trade-offs in target setting between the desire for clear future settings as a basis for investment and other key decisions, and the need for flexibility to respond to changing circumstances, experience and the evolution of climate ambition. Both have value, and the approach to target setting and updating will necessarily be a compromise. Suitable compromises may be borrowed from other climate policies, including the Safeguard Mechanism.

The recent Safeguard changes prescribe emissions baseline decline rates from 2023-24 to 2029-30, and offer indicative decline rates from 2030-31 onward. Decline rates for 2028-29 and beyond are to be reconsidered at a broad scheme review in 2026-27, informed by the decision on economy wide emissions goals for 2035 that will be taken in 2025. Subsequent decline rate decisions are likely to follow the five-year cycle of Paris Agreement national commitment-making.

A similar approach in the FES context might see initial targets set firmly from scheme commencement to 2029-30; indicative guidance beyond that based on a trajectory consistent with Australia’s long-term national emissions goals; and a commitment to regularly update and extend firm FES target settings so as to reflect the cycle of national emissions commitment-making and offer at least four years of firm guidance to suppliers at all times.

To ensure substantive coherence and consistency of process, reviews of FES targets should be conducted by the Climate Change Authority, with direct support or seconded staff as appropriate from the relevant Departments and agencies. Reviews, while substantial and distinct, should form a coordinated part of the wider CCA advisory process on Australia’s policies towards its national emissions goals.

How should the Government address the risks of the standard being found to be too weak or too strong while it is operating?

One of the challenges in designing the FES is the need for long-term decisions in the midst of rapid market evolution and technological change. We have seen examples in Australia and overseas of the ways in which initial settings in various energy, industry and transport policies can go awry and produce unwanted outcomes – or simply make much less difference than planned – due to incorrect assumptions, unexpected developments and unintended loopholes.

There are at least two levers through which scheme design might enable or limit a response to these surprises:

- How far ahead are trajectories considered to be locked in, as opposed to indicative?
- For how long can credits for overperformance against scheme targets be banked?

As argued above, the length of the firm period for scheme trajectories needs to balance supplier's need for planning guidance with policymakers' need for flexibility. Four years of firm guidance seems reasonable.

With respect to the banking of credits for outperforming annual targets, this is similar to questions that arose in the design of the recent Safeguard Mechanism reforms. Amidst rapid changes in the car market, it is possible to imagine targets that are outstripped for several years by market-led change that runs faster than expected. The result might be an overhang of credits that either weakens the future impact of scheme targets, or requires corrective policy changes that will be fraught and time consuming to develop.

Similar to the recommendation we made – so far unsuccessfully – in the context of the Safeguard Mechanism, a reasonable answer would be to build a limited lifespan into credits issued under the FES. A rolling vintage window, with credits valid for use within a set period following issuance, would be more efficient and less distorting than a series of scheme phases. A window matched to the minimum firm target trajectory period, which above we suggest should be four years, would make sense.

Should an Australian FES adopt two emissions targets for different classes of vehicles?

Ai Group has limited comment on this topic. On the one hand, distinguishing targets for distinct vehicle classes is common practice overseas and the general principle of convergence with international approaches, as appropriate for a relatively small and exclusively import-dependent market, would suggest that Australia should follow suit.

On the other hand, there are important risks to both single-class and dual-class approaches. As has been noted, a dual class approach can risk inadvertently incentivising suppliers and consumers to switch vehicle classes in ways that are both distortive and undermine overall scheme goals. By contrast a single-class approach, for better or worse, might well result in suppliers and purchasers of larger vehicles cross-subsidising suppliers and purchasers of smaller vehicles. Whatever the debatable merits of this, such distributional impacts would be complex and fraught to navigate.

On balance, the two-class approach seems most practical. Furthermore, it also reflects the disparity between the preference of Australian consumers for light commercial vehicles (i.e. Toyota HiLux) and large SUVs (i.e. Mazda CX5), and the primacy of smaller sedans in markets where electrified technologies are most prevalent (such as in the EU). However, target selection and scheme design need to be calculated and updated to achieve overall objectives while minimising, or at least accounting for, any inadvertent changes in the attractiveness of different vehicle classes to end users.

Two distinct emissions targets for light vehicles can also help set a framework to eventually expand the FES to include heavy commercial vehicles (over a mass of 4.5 tonnes), to assist with decarbonising the road freight sector.

Are there other policy interventions that might encourage more efficient vehicle choices?

Policy interventions that will incentivise turnover of older, less efficient vehicles should be investigated. The rate of turnover in the national fleet will need to be accelerated. Financial incentives such as the US federal electric vehicle incentive (excluding the local assembly requirement), or a cashback scheme for retiring vehicles could be a feasible way to encourage uptake of LZEVs. There may be many other options to accelerate replacement.

Any incentives for vehicle replacement face a difficult set of design challenges.

- Some vehicles will be replaced anyway, raising the risk that an incentive does not produce additional action;
- Some vehicles are driven much more than others, and their replacement would have a much bigger impact on fuel consumption and emissions, but they may be hard to identify;
- Replaced vehicles may be on-sold and continue to be used for their operating life in the absence of some conditionality on incentives.

Notwithstanding these challenges, upping the rate of new vehicle sales will be essential to achieve overall emissions reduction goals and accelerate the realisation of other benefits of new energy vehicles. Further study and development will be needed to ensure that the design of any such measures both increases the overall rate of vehicle replacement and speeds the decline in fleetwide emissions.

This will need to be done despite the genuine concerns regarding availability of critical minerals, materials efficiency and embodied emissions, and issues around the waste generated as we speed up the changeover, which will need to be addressed in tandem with the trend in uptake of new LZEVs.

Policy makers should also consider turnover incentives for heavy commercial vehicles, where the average fleet age is even older than it is for light vehicles. For example, the estimated average age for heavy trucks across Australia in 2022 was 16.3 years – significantly higher than the average age of passenger motor vehicles of 10.8 years.¹

Additional flexibility mechanisms to minimise impacts on consumers

To what extent should the Australian FES allow credit banking, transferring and/or pooling?

Flexibility mechanisms are very important to moderate the overall costs of a FES and to even those costs out across liable parties. In the absence of banking, transferring and pooling options, individual parties might experience much higher marginal compliance costs than their peers due to the particular market segments they serve, or transient individual circumstances. Enabling trading will help ensure that the marginal cost of compliance is comparable across the whole cohort of covered entities, maximising the whole of economy balance of costs and benefits.

However, flexibility mechanisms can also go awry – particularly if mistaken scheme settings and erroneous economic assumptions result in a flood of credits that, while technically valid, undermine the policy intent. As argued above, the best answer may be to specify a limited lifespan for credits following issuance.

Bonus credits for new/innovative technologies

Should an Australian FES include credits for using low global warming potential air conditioning refrigerants, and if so, for how long should this credit be available?

While there is a case for the inclusion of a broad range of vehicle emissions reduction opportunities in a FES, the existing national policy framework for synthetic greenhouse gases complicates the issue. The Ozone Protection and Synthetic Greenhouse Gas Management Act underpins Australia's phasedown of high-global warming potential refrigerants, as committed through the Kigali Amendment to the Montreal Protocol.

¹ Bureau of Infrastructure and Transport Research Economics, Motor Vehicles Statistical Report (Australia), January 2022, p. 9., October 2022

Supply of these gases is limited and will decline over time. In this overarching context, it would appear that narrower mechanisms to discourage particular applications of these gases may not achieve overall reductions in emissions; if there is less demand from the automotive sector, more quota would be available for economy-wide supply of these gases.

On this basis it is probably best not to incorporate credits for low GWP refrigerants in the FES. Further reductions in these emissions could be better pursued by reforms to the economy-wide phasedown, which would also ensure that reductions occur these gases can most affordably be replaced. That phasedown should in any case be revisited in light of the deepening of national emissions goals, and with consideration of more flexible and efficient approaches than the current grandfathered importation rights.

If there are concerns from suppliers about their ability to meet targets using internationally available models without refrigerant credits, these are better addressed by adjusting the level of the overall FES targets to ensure they are challenging but feasible.

When should a FES start?

When do you think a FES should start?

There are two aspects to FES commencement: how soon does it formally commence, and at what point do the targets under it require activity that differs from business as usual? The constraint on the former is the complexity of scheme design and the need for deep consultation and iteration to ensure a robust design. This could be achieved faster by adapting an off-the-shelf design, whether the existing Australian industry-led voluntary scheme or an overseas scheme. However, the constraint on the latter is the ability of suppliers to reshape their supply chains in time to meet a requirement.

The result is that Australia could commence a fully-fledged FES design immediately and still face a delay of at least a couple of years before it can be expected to change outcomes in the marketplace.

On balance, and given the issue discussed above of lags in the impact of the new vehicle sales mix on the total vehicle fleet, the priority should be to finalise scheme design and set initial targets as soon as possible, while allowing a combination of sufficient time to prepare for targets or, if meaningful targets commence earlier, flexibility to make up a shortfall via overperformance in following couple of years.

Should the Government provide incentives for the supply of EVs ahead of a FES commencing? If so, how?

Ai Group is of the position that the existing incentives should be maintained until the FES commences. This is on the basis that FES commencement should be swift, and there will be limited time for design and consultation on additional incentives. Presently, Australia lags significantly behind many jurisdictions around the world for incentives – which have led to rapid EV uptake in economies such as Norway.

Penalties for non-compliance and enforcement mechanisms

What should the penalties per gram be? Would penalties of A\$100 per gram provide a good balance between objectives? What is the case for higher penalties?

It would make sense to express the value of the penalty as a decimal of the existing civil penalty points system used in other relevant legislation such as the Road Vehicle Standards Act 2018. Given the current value of the civil penalty unit at \$275, it may make sense to align the per gram/km value to somewhere between .35 and .5 of a penalty unit.

What if any concessional arrangements should be offered to low volume manufacturers and why? If so, how should a low volume manufacturer be defined?

Ai Group does not support concessional arrangements for low volume manufacturers. With adequate flexibility mechanisms available to all participants, low volume suppliers should face a level playing field.

Information disclosure

What should the department keep in mind in designing the system for suppliers to provide information and in relation to record keeping obligations?

Use of a harmonised testing procedure (as per response below) would enable global manufacturers, who are already compliant with other jurisdictions using the same system, to use existing data for compliance purposes. In addition, the current voluntary reporting system should be looked at to investigate what information is already available for reporting purposes and if any additional data should be required for completeness.

Governance arrangements and other matters

Should the regulator be the department? What other options are there?

Ai Group would be supportive of the Department being regulator for the FES, given there is sufficient funding provided. This also aligns with the Department's role as the regulator for new vehicle Australian Design Rules (ADRs) under the *Road Vehicle Standards Act 2018*, which ensures strong understanding of Australia's new vehicle market. Furthermore, the Department also oversees Australia's efforts to harmonise Australian vehicle standards with international regulations. This principle will also be extremely important for a successful and sustainable FES in Australia.

The Clean Energy Regulator would also be a reasonable option for regulator if the Department is not able or willing to do so, as it would fit into their remit as the authority responsible for other matters related to the national emissions reduction targets.

Ai Group would like more information on the how intended regulator will be funded and if it will include a cost-recovery mechanism.

Should an Australian FES use WLTP test results in anticipation of the adoption of Euro 6 and if so, what conversion should be applied to existing NEDC test results, or how might such a factor be determined?

Ai Group is supportive of the use of the Worldwide Harmonised Light-Vehicle Testing Procedure. Given these tests are lab-based and not truly representative of on-road emissions, there could be scope to include the Real Drive Emissions test (RDE) as a secondary verification of data (especially for particulate, SO_x and NO_x emissions in line with the adoption of Euro6).