


THE AUSTRALIAN

Fuel-efficiency regulation impact draft is a fantasy

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2 HOURS AGO AUGUST 10, 2018 •  1 COMMENT

Just two good things can be said for the government's draft regulation impact statement on "improving the efficiency of new light vehicles".

The first is that it at least attempts a cost-benefit analysis of the "fuel efficiency" standards that are winding their way, seemingly inexorably, towards adoption.

The second is that it is obvious from the outset that it makes a complete hash of it, sparing those who don't have to read the entire document hours of pointless agony.

That is not to deny that the draft's results are striking.

Imposing fuel-intensity targets on new light vehicles would, it finds, yield benefits that vastly exceed the costs. And it's better than that: the tougher the targets, the greater the gain, with the move from the least to the most stringent standard increasing benefits by \$19 billion while raising costs by only \$10bn.

Little wonder this modelling, like that for the national energy guarantee, has the Greens panting: "Why stop there?" If the incremental gains are so large, why not go further?

The reality is that the analysis is deeply flawed. Indeed, merely correcting its most

egregious mistake ensures that even the least stringent target it examines fails a cost-benefit test.

Start from the purported benefits, which consist of reduced emissions and of fuel savings that accrue as buyers shift to less fuel-intensive vehicles.

It is the fuel savings that matter, as they account for 90 per cent of the total gains. But it is hard to see why reduced spending on fuel would count as a benefit.

After all, consumers could already choose a Prius rather than a Hummer, slashing their fuel outlays in the process; if they don't, it is because they value the added benefits they obtain from a Hummer compared with those yielded by a Prius at more than its added costs, including higher fuel bills.

To claim, as the draft repeatedly does, that a Hummer is less "efficient" than a Prius is consequently nonsense: both use as much fuel (and other inputs) as they need to deliver the package of attributes they provide.

And to claim that the consumers who chose the Hummer would be better off had a regulation forced them to switch to a Prius defies comprehension.

Yes, their fuel bills would fall; however, that gain has to be set against the loss of the many attributes they value in the Hummer — and (given that they prefer the Hummer) the result must be a net loss.

But instead of making that adjustment, the draft just reports the reduced fuel spending as if it were a net increase in consumer welfare.

That doing so is problematic does not escape the report entirely. Its response is simple. Descending to a level of hand-waving that would usually require at least as many limbs as a centipede, it turns to the regulator's best friend: consumers, it says, are poorly -

informed — they do not realise that a Prius uses less fuel than a Hummer.

Now, surveys suggest otherwise, with a study by the Australian Automobile Association finding that Australians, when they buy a car, rate fuel efficiency and reliability as the two most important considerations.

And the myriad government programs that deluge consumers with fuel use information can only boost consumer awareness further.

Despite that, it may be that some consumers remain ill-informed; but why would they systematically underestimate fuel use, rather than making errors that — averaged over the population — cancel out?

And if consumers are leaving so much money on the table, why don't the brands they would switch to increase their advertising expenditure?

The draft doesn't let such quibbles stand its way.

Having noted that “there is very little evidence on how (consumers) assess the benefits of fuel efficiency”, it assumes consumers are so woefully ignorant that, had they only known, they would not have chosen the cars that use more fuel. The reduction in fuel spending is consequently counted as an unmitigated gain.

Having made those errors, the draft proceeds to examine costs. Unfortunately, that discussion is no less confused.

Thus, while the draft analyses the additional costs producers would incur to meet the standards, it states that it is agnostic as to whether they would be passed on in higher prices and, if so, to what extent. It therefore makes no attempt to separately assess price impacts.

However, as the cars are imported, the added costs matter only if they are passed on; if they weren't, the entire burden of the regulations would be borne by car producers overseas — which seems wildly implausible.

And it is surely obvious that it is only if the greater costs are passed on that consumers will switch to less fuel-using vehicles, as the draft assumes.

As a result, for the draft's results to be at all sensible, car prices must rise significantly, imposing additional efficiency costs it ignores — just as it ignores the effects on the low-income households that are likely to be hit hardest.

Ultimately, the problem with this draft is that it lacks a coherent conceptual framework. For example, although it uses the term “efficiency” more than 100 times, it never spells out what it means — understandably so, as it employs the term in a way that bears no relation to conventional economics.

As far as it is concerned, a pizza with 10 olives is less “olive efficient” than one with five, and a regulation that capped the number of olives on pizzas would generate net gains measured by the olives “saved”.

Given that definition, it naturally finds the proposed regulations pass the test. But if one sets aside the fuel savings, as one should, the estimated costs of even the least stringent standard are six times greater than the benefits — and that takes no account of a range of costs the draft overlooks.

The real question is how such a report could possibly have been produced. The answer is that our entire system is pervaded by the belief that “saving” energy is an unqualified virtue. Yet cutting energy consumption is no more inherently meritorious than reducing the consumption of pianos, parachutes or pavlovas.

So let's repeat it, for the sake of the children: eating people is wrong; using energy is not. Until that is understood, public policy in this area will remain a hopeless muddle.