



OBSERVATIONS

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We Need a More Intelligent Energy Policy

In 1947, Winston Churchill proclaimed that, "Democracy is the worst form of government, except for all the others." One could say the same thing about gasoline: environmentally harmful, politically explosive, non-renewable - but it suites the task of vehicle propulsion like few other substances. There's more energy in an injector-pulse of gasoline than, say, ethanol, and there's a century's worth of development and industrial experience in the area of oil-based fuels that simply doesn't exist to the same degree among alternative fuels. Like democracy, we're stuck with gasoline until the inevitable successor technology is properly ripe.

A year has passed since we last devoted this space to any of the usual gasoline issues (i.e. fuel efficiency and energy conservation), so it is incumbent upon us to revisit the topic and extend the discussion a bit further.

We covered two main areas in last year's autumn *Observations*, both deeply linked to the efficiency/environment question. In September 2005, we discussed the benefits of diesel fuel and its success in Europe as a viable and desirable alternative fuel solution. The following month, we highlighted some existing products in the OEMs' international lineups that might do well in Canada's fuel-cost-conscious vehicle marketplace.

Unfortunately, what little movement has occurred with regards to the diesel issue has been retrograde. The Jeep Liberty CRD has been discontinued, and Volkswagen will end sales of their current-generation diesel products as the Tier 2 emissions regulations come into effect next January. A diesel variant of the Jeep Grand Cherokee joins the smart fortwo and Mercedes-Benz's E and ML-Class diesels, but with the

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absence of VW's products, 2007 may stand as a decade low point for diesel availability in the passenger car arena.

(GM, Ford, and DaimlerChrysler continue to offer diesel powertrain in their full size pickups, but those engines are engineered more for towing strength than stellar fuel mileage).

The prospects for greater diesel penetration in Canada look grim in the very short term, but the next few model years promise a cohort of next-generation diesel models from Volkswagen, Honda, and Mercedes-Benz, to name three of the more visible proponents of diesel powertrains this fall.

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We have some slightly better news to report on the other issue (i.e., the North Americanization of small/fuel efficient vehicles from foreign markets). Since last fall, a number of key products in the subcompact arena have either appeared fresh or undergone substantial redesigns. The Toyota Yaris (formerly Echo), Chevrolet Aveo, Hyundai Accent, and Kia Rio are now more accommodating, more fuel efficient, and - ostensibly - more desirable than they were a year ago. Joining these segment stalwarts are the Honda Fit, Nissan Versa, and Suzuki SX4. The average age of product in this segment has dropped considerably in the past few years, while feature content, power, refinement, and fun have risen commensurately. These were the sorts of cars that - in years past - manufacturers reserved for their European and Asian-market audiences. Rising energy costs and renewed consumer interest in economical, no-compromise transportation have made the subcompact segment viable once again.

Of course, both of the issues mentioned above are neatly boxed within the realm of the new vehicle market - significant, yes, but not the biggest piece of the automotive emissions puzzle that faces our government today.

Environmental issues have crept back into the spotlight, lining up

among the government's top tier portfolios this season. Stephen Harper's still-fresh caucus has taken the opportunity to politicize energy issues for their benefit. As long as their actions are viewed as "environmentally tough," the actual biological impact of their policies doesn't seem to matter. In Ottawa, being tough on the environment means ganging up on the automotive industry.

In going after the auto sector, there are two things that the government is attempting to avoid. First, they must obfuscate the roll of Big Oil in the environmental question. Second, they must avoid placing any blame on potential voters. The auto sector stands alone as a big, soft political target.

Vehicle companies already employ all kinds of technologies that help the environment, but externalities limit their effectiveness. Getting gasoline in this country is a gamble; it might or might not be clean, the latter a consequence of our lax national fuel standard. Prolonging the days of unregulated unleaded is bad for the environment, but the institution of a comprehensive policy would translate into billions of Big Oil spending.

Beyond the area of corporate responsibility and government action, we have before us an

extraordinary interface between product and policy, the likes of which only occurs once or twice within a generation. There are over 3 million consumers who, for good or bad reasons, are driving old "smokers", the most environmentally unfriendly vehicles imaginable. Where is our national vehicle scrappage program? Where is our high mileage tax? No sir, that program would force the government to do something it doesn't want to do.

As I've mentioned before, new cars only account for a small portion of the Canadian vehicle fleet. Said fleet has a turnover time of roughly 25 years. Attacking the environmental question through the small window of the new vehicle market ignores the massive installed base.

This is the very essence of the issue, the core of the problem, and the fundamental motivator. Someone has to deliver a message that consumers fundamentally do not want to hear. The message, simplified for brevity's sake, is as follows: Using an old vehicle as daily transportation for a single occupant is no longer a socially acceptable practice. People need to be more attentive to the environment with their vehicle purchasing, ownership, and usage habits. That may mean owning fewer vehicles, getting rid of an old polluter, buying a more fuel-efficient vehicle, driving less,

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enhancing drive clean or air care programs or a dozen other things that put more onus on consumers. Unfortunately - and understandably - no politician wants to deliver this message.

Indeed, I understand the political fallout cloud that threatens to rain down on the minority Conservatives. When I proposed a high mileage tax two months ago, I received hundreds of emails from angry Canadians. They viciously attacked me. I understand how difficult it is for politicians to indulge in the unpopular, but do we not elect politicians to lead? Is leadership not necessary at this juncture?

So far, the government has shirked its responsibility. They have instead attempted to enlist our market's twenty vehicle OEMs to deliver the environmental message. It is the consumer who needs to make the most movement here, not the automotive sector, so the burden lies with the government to break the hard truth. I find it interesting that even in these times of yo-yoing gas prices, the consumer continues to place a low priority on environmental friendliness and fuel efficiency. Market research indicates that those factors have risen slightly from the beginning of this decade, but they still lag behind sexier things like performance, drivability, fit finish, and exterior design.

The Environment Ministry's suggestion that greater regulation of the auto sector is the solution to our problems represents a huge step backwards. Their attitude has a decidedly early-1970s ring: "If you don't force these companies into doing something, they will never address the issue." How narrow minded! How deeply and totally can a group of

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people misunderstand this issue? The auto industry actually has a long history of aggressively and proactively addressing this and other social policy agenda items in a responsible way.

Canada also has a long history of doing the right thing when it comes to regulating the automotive sector. This is an oversimplification, but our approach has always been to watch the Americans clear the grass in a variety of directions (making several wrong turns along the way), learn from their mistakes, and put in place a "made in Canada" set of regulations that are by-and-large more appropriate for this country. Our "U.S.-style" voluntary regulations have been implemented on less aggressive time schedules

so that ordinary Canadians haven't had to bear the high cost of doing things quickly. The industry has never missed a voluntary standard, so why change now?

Furthermore, I don't subscribe to the job loss story that some may champion (i.e. the CAW). Yes, we have 800,000 jobs directly related to the auto sector, with 150,000 of those in manufacturing. However, almost all of these jobs (85%) involve the building of vehicles and parts for the U.S. market - plants and jobs which are not threatened.

I hope the auto sector doesn't use the job loss issue as ammunition as they fight this initiative. What is threatened is the rate at which future investments flow into the Canadian auto sector. Manufacturing, distribution and retail operations all require substantial continued investment in order to remain internationally competitive. In manufacturing alone, we need to invest \$4 billion every year to keep pace with the global auto sector. It's difficult enough to attract this level of investment to Canada in a normal regulatory climate, but we have been able to meet our high targets each and every year. Think about how tough it will be in the future to fly off to head offices in the U.S., Japan, Europe and Korea to make a case for new or renewed investments.

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It will be a tough sell. Foreign businesses don't really care about the politics in Canada, and they certainly don't care whether the Conservatives or the Liberals have parliamentary control. Potential investors simply want an efficient economy where they can get a proper return on their dollar. The new Minister's actions are sending the wrong message to these investors.

I also don't buy the argument that, together with California, there will be more volume and more synergies and thus more impetus to move technology forward. First of all, how many assembly plants do you find in California? Just one! Second, technology is moving forward very rapidly. Does anyone outside the realm of hardcore conspiracy theorists truly believe that the automotive sector is holding something back? Billions and billions of research dollars are invested every year so that the findings can sit idle on the engineering department's hard drives? Serious people know better than to entertain such ideas.

The over-regulated nature of our industry forces OEMs to take unnecessary risks. No one can imagine how risky it is for an OEM as they move forward on various technologies. By way of example, there are currently nine fuel strategies under development in various labs around the world (conventional fuels, diesel, bio-

diesel, ethanol, natural gas, propane, electric, methanol and hydrogen), with hybrid combinations increasing the count several times. Many of these are showing promise but it will take huge capital to bring any one of them to marketable fruition, yet alone two or three of them.

The automotive sector doesn't have enough money to indulge every one of these dreams, and the alternative fuel future is so risky that they are spreading their resources to cover as many bases as possible. What happens if they bet on the wrong horse? Toyota is favouring a gas-electric hybrid strategy, GM has chosen an ethanol strategy, while DaimlerChrysler and Volkswagen are continuing to pursue diesel development. What if tough regulations force the OEMs to put more eggs in more baskets? No one basket ever fills up. Furthermore, as with any situation where no clear winner is visible among competing nascent technologies, the risk exists for OEMs to invest their futures in completely fruitless research. Theoretical research is the province of universities, not corporations.

The automotive sector has faced the challenge of reducing emissions that are harmful to individuals, successfully eliminating 99.6 percent of these pollutants from modern tailpipe

emissions. Yes, it probably took too long; yes, it took a heavy hand from the U.S. government; but the corporate culture of the 1960s - which required a parental hand to discipline it into responsible behavior - is long gone. Nearly fifty years along the learning curve, we are dealing now with a mature technology, a mature industry, and a mature attitude towards environmental responsibility.

A handful of companies no longer control the market. There are eight massive global entities that compete side by side in the market. These companies have turned their collective efforts to the issue of greenhouse gases (i.e. emissions that are explicitly harmful to the environment, only indirectly so to individuals). This issue is larger than the simple market pressures that guide normal product development; it is an existential issue - a survival issue - and every company knows that the future rides on the backs on its emissions engineers. Throwing Canada's measly 1.5 million sales into the annual global pie of 60 million vehicles will not result in faster movement on the part of the OEMs, just higher costs for Canadian consumers and higher risk for the OEMs. Playing politics with an industry employing over 800,000 Canadians is very dangerous. **DAR**