

<p><b>Document Title:</b></p> <ul style="list-style-type: none"> <li>Regulatory Coherence – Emissions Regulations</li> </ul>
<p><b>Purpose:</b></p> <ul style="list-style-type: none"> <li>For Consideration</li> </ul>
<p><b>Issue:</b></p> <ul style="list-style-type: none"> <li>Regulation is an integral part of a well-functioning economy and can be used to achieve desired economic, social, and environmental objectives. The task for government, and for the ABAC to encourage, is to find a balance between the need for regulation, and the cost and economic inefficiencies that regulation can impose. Approaches to regulation should be trade-friendly and not distort markets or place unnecessary burdens on economic actors.</li> </ul>
<p><b>Background:</b></p> <ul style="list-style-type: none"> <li>Regulatory coherence is not about less regulation nor is it about more regulation. More than just the harmonization of regulations, it is about improving the process by which economies develop regulations, developing best practices, and finding common standards acceptable to multiple economies. It leads to better regulation that is effective, but also not market-distorting. Regulatory coherence is about competitiveness. An optimal regulatory environment allows the market to be more competitive and innovative.</li> <li>The goal of regulatory coherence is to develop effective regulation that facilitates the trade of goods and services, as well as stimulates competitive economies and the region's economic growth.</li> <li>The paper includes the following recommendations and their impact on global emissions regulations:       <ul style="list-style-type: none"> <li>Harmonized international standards should be used as the basis for domestic regulation</li> <li>Measures of similar strength and enforcement implemented in other economies should be accepted as being equivalent to domestic measures.</li> <li>Government regulatory institutions should promote approaches to regulation and implementation that are trade-friendly and avoid unnecessary burdens on economic actors</li> <li>Regulatory institutions should address unnecessary costs of regulation</li> <li>Regulatory impact assessments (RIA) can be used to assess the impacts of new or existing regulations on business,</li> <li>Governments should incorporate a consultation mechanism amongst each other and with affected stakeholders to enhance accountability, promote mutual learning and best practices</li> </ul> </li> </ul>
<p><b>Proposal/Recommendation:</b></p> <ul style="list-style-type: none"> <li>ABAC USA is requesting that 3 other ABAC economies conduct a similar sectoral assessment of regulatory coherence on their respective industries to be presented at ABAC III.</li> <li>Include language in the ABAC Report to Economic Leaders stressing the importance of regulatory coherence; include this paper as well as other economies sectoral summaries in an annex to the Report.</li> </ul>
<p><b>Decision Points:</b></p> <ul style="list-style-type: none"> <li>Endorsement of the recommendation listed above.</li> </ul>

## **Benefits of Improved Regulatory Coherence**

Regulatory coherence is not about less regulation nor is it about more regulation. It is about improving the process by which economies develop regulations, developing best practices, and finding common standards and timing acceptable to multiple economies. It doesn't require loss of regulatory power or sovereignty. It creates better regulation that is effective, but also not market-distorting. Regulatory coherence is about competitiveness; an optimal regulatory environment allows the market to be more competitive and innovative.

Regulatory coherence results in a higher degree of confidence that regulations are providing the appropriate safeguards which are properly enforced, including enhanced confidence in traded products and services. It reins in unintended consequences of regulation and increases consumer access to a wide choice of goods and services at better prices while boosting the competitiveness. It would also better facilitate SMMEs' entry into foreign markets.

## **Costs of Divergent Regulations**

The trade cost that results from divergent regulations can be a quite significant. The growth of disparate regulatory regimes creates uncertainty, high costs and inefficiencies, and enforcement challenges for individual countries, their consumers, their industries and their workers. A 2009 study on the results of efforts to reduce divergent regulation between the US and EU found that exports would increase by 2.1% for the EU and 6.1% for the US if 50% of Non-Tariff Measures between the US and EU were aligned.

Regulatory burden also acts as a drag on the competitiveness of an economy. The US Government's Small Business Administration estimates the total US federal regulatory burden to be 1.75 trillion dollars. This translates to over \$15,000 per U.S. Household, just over \$8,000 per employee or over \$10,500 per employee in companies with less than 20 employees. These costs associated with unnecessary divergent regulations are ultimately borne by the consumers of regulated products.

Higher costs due to regulatory inefficiencies or unnecessary divergences carry an economic penalty. Governments, and ultimately the tax payers, face the cost of developing and enforcing regulations. Over the last decade in the United States, between 2000 and 2010, annual budget outlays for regulatory activities increased 75.5 percent in real terms, for a real dollar increase of \$21.7 billion.

## **Approaches to Regulatory Coherence**

Approaches to regulation should be trade-friendly and avoid unnecessary burdens on economic actors. Regulation is an integral part of a well-functioning economy and can be used to achieve desired economic, social, and environmental objectives. The task for government, and for the ABAC to encourage, is to find a balance between the need for regulation, and the cost and economic inefficiencies that regulation can impose.

## Designing Regulations

- Where possible, international standards should be used as the basis for domestic regulation. Standards developed internationally provide a solution to fragmented regulatory systems. Provisions that differ from existing international standards should be based on genuine differences in regulatory objectives or in available means to achieve them.
  - *What it means for Emissions Regulations:* Unique national standards represent an additional burden and conflict with the trend towards global coherence of emission standards. In addition to country specific regulations, local or regional requirements further complicate products. For example, the US has the California Air Resources Board which specifies requirements that are not necessarily harmonized with the rest of the country. There are other areas in the world, where local regulations are more stringent than national regulations. It is understandable that in certain areas, perhaps due to local air quality issues, that the differing emission performance standards are desired, with it being preferable to see adherence to such localized regulations be based on the use of verified or certified products because the development of those products can be leveraged elsewhere or leveraged at a later time, rather than force unique local product requirements, specific only to a certain locale.
- Regulations should be performance based and not prescriptive based. Where foreign regulatory measures differ from those developed domestically, but nonetheless adequately fulfill the domestic policy objectives, acceptance of these measures as functionally equivalent to the domestic measure, where possible, will encourage market openness and stimulate competition. Producers and services suppliers should have an open, transparent, and accessible process available to them if they want to make a case for equivalence. Recognition can also be facilitated through adoption of mutual recognition agreements.
  - *What it means for Emissions Regulations:* There are at least 9 emission regulations that non-road equipment manufacturers need to deal with in order to produce and sell product worldwide and that number is growing as more countries begin to regulate emissions. (US, EU, Canada, Japan, China, India, Korea, Russia, and Israel, all have different emissions regulations or implementations) And, in some instances, international organizations such as the International Maritime Organization (IMO) provide an additional measure of regulatory activity.
  - Even when emission levels appear to be the same, differences in test procedures and other certification requirements can require manufacturers to design for, and produce, different products for different areas. There are at least fourteen<sup>1</sup> typical aspects to a regulatory regime that are used in differing combinations by differing regulatory authorities, creating a challenging mix of requirements that inhibit product development and economic efficiency. The resulting variation in regulatory approaches drive limitations on consumer choice and innovation as manufacturers design to meet multiple market requirements, especially in product groupings characterized by low per-configuration unit volumes.
  - Manufacturers of specialized off-road machines such as mining trucks, track-type tractors or industrial power equipment are impacted particularly hard by lack of emissions regulation coherence due to the low volumes per individual product configuration and the high variability in product types and work performed. For example, ABAC Member Caterpillar offers thousands of engine configurations and ratings used to power its over 200 different types of equipment and those of companies purchasing Caterpillar engines to power their own products. For them,

regulatory coherence would result in hundreds of millions of dollars saved, perhaps upward of \$1B for each emissions tier change. Multiply that by the various engine and equipment manufacturers around the world and it is clear that a lack of regulatory coherence results several billion dollars of unnecessary costs for industry and consumers.

### Regulatory Institutions

- Manufacturers, service providers, retailers, SMMEs, and farmers face duplicative and oftentimes opaque regulatory processes which are often interpreted without consistency even within the same regulating authority that fail to take into account their views and experiences. Government regulatory institutions should promote approaches to regulation and implementation that are trade-friendly and avoid unnecessary burdens on economic actors by taking into account equivalence of foreign regulations, doing away with duplicative or outdated requirements, and embracing regulatory alternatives.
  - *What it means for Emissions Regulations:* Efficient approaches by regulatory institutions benefit international commerce. A trade-friendly approach saves capital spent each year on materials and services for development, testing, manufacturing, inventory, and logistics in dealing with different levels of emissions regulations.
- Regulatory institutions should address unnecessary costs of regulation to ensure that economic actors can manage risk and operate in a pro-competitive environment, allocate resource, innovate, and seek more efficient techniques over time. This will strengthen sustainable economic growth and enhance living standards.
  - *What it means for Emissions Regulations:* In addition to certification testing costs, there are significant amounts of additional development, manufacturing and redundant conformance costs that could be eliminated with regulatory coherence. Product labeling, inventory, logistics of distribution, even regulatory affairs functions are currently repeated for the different regulations. International regulatory coherence is a means to promote the rapid introduction and deployment of cost-effective new technologies to reduce emissions, increase energy efficiency and promote safer vehicles in the future. Harmonized emission levels improve the efficiency of engine development, product manufacturing, and worldwide global trade.
  - Internationally harmonized test protocols for emission control contribute to reducing pressures on the environment and to more efficient use of energy. They also facilitate innovation and competitiveness by allowing manufacturers to develop engine models that can meet internationally consistent emissions regulations.

### Regulatory Impact Assessment

- Regulatory impact assessments (RIA) can be used to assess the impacts of new or existing regulations on business, the environment, government, administration, or any other impact that is of relevance to the regulation-maker.
  - *What it means for Emissions Regulations:* RIA lessens the negative impact that regulations have on business by addressing longer term impacts. Beyond the initial point of sale,

emissions coherence is needed to respond to the implications of globalization on off-road manufacturers' customers. In an increasingly globalized world, it is no longer acceptable to produce a product with only regional or national compliance when products move across borders.

### Consultation Mechanism

- In order to improve the quality of regulation and the regulatory process, governments should incorporate a consultation mechanism to enhance accountability, promote mutual learning and best practices, and build a framework that is flexible enough to take account of the diversity of interests for each policy proposal. Consultation supports transparency and accountability, as well as improves the overall effectiveness and effectiveness of policy.
  - *What it means for Emissions Regulations:* Engine and equipment manufacturers around the world have been working with regulatory bodies in an effort to try and harmonize engine emissions requirements, with much of this work done within the United Nations Environmental Program. There has been limited progress made through adoption of Global Technical Regulations (GTRs), but variation amongst the fourteen or more different prime regulatory provisions referenced above create considerable confusion and disharmony in actual implementation. So, even while emission thresholds appear similar, even arguably identical, those coherences are often only superficial.

### Enforcement Mechanism

- Regulation is an important aspect of an economy's ability to protect its populace from potential harm and to engage in the global marketplace; however the case for regulation needs to be made carefully. Businesses need lead time and stability with regard to regulatory frameworks and their enforcement. Regulatory coherence will allow regulators to fulfill their enforcement mandate through improved transparency in regulation and enforcement.
  - *What it means for Emissions Regulations:* Transparent enforcement is critical to regulatory certainty. Equitable enforcement between domestic and foreign participants in a marketplace enhances competitiveness for both the domestic and foreign market participant. Certainty supports the business case for development of products to regulatory requirements and enhances protection of the environment.

### Alternatives to Regulation

- Whether a prescriptive regulatory approach or an alternative to regulation is adopted, the methods to deal with a perceived problem should ideally have the following characteristics: administrative simplicity, flexibility, efficiency, certainty and equity. Regulatory tools should be employed to achieve a desired regulatory objective
  - *What it means for Emissions Regulations:* Regulatory simplicity based upon performance standards provides the opportunity to effectively engineer solutions to challenges put before manufacturers by regulatory conformance. Flexibility that facilitates a smooth transition to new regulatory standards, particularly in businesses with high levels of

product variation and low per-configuration volumes makes it possible to implement more substantial improvements over complex product lines. Certainty is needed to justify the investments needed to meet regulations and equity provides the balance competitive environment that promotes innovations and development efficiency.

## **Conclusion**

- As the world continues to progress with emissions reductions, greenhouse gas reductions, and an overall more efficient use of natural resources, coherence of worldwide emission regulations would not only help international commerce, but more importantly would eliminate unnecessary costs associated with materials and services spent each year on development, testing, manufacturing, inventory, and logistics in dealing with different levels, or flavors of emissions regulations.

## **Proposal/Recommendation:**

- ABAC USA is requesting that three other ABAC economies conduct a similar sectoral assessment of regulatory coherence on their respective industries.
- Include language in the ABAC Report to Economic Leaders stressing the importance of regulatory coherence; include this paper as well as other economies sectoral summaries in an annex to the Report.

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<sup>1</sup>These include:

- Certification documentation & review
- Certification test
- Deterioration factor test
- Delegated final assembly
- Labeling
- Emissions warranty
- Confirmatory testing
- Production line testing
- Defect reporting
- Selective enforcement audit
- In-use testing
- On-board diagnostics
- Equipment registration,
- Inventory, & regulatory transition governance