POLICY UPDATE

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CHINA PHASE 3 NEW PASSENGER CAR FUEL CONSUMPTION: PROPOSED IMPLEMENTATION RULE

ICCT **POLICY UPDATES** SUMMARIZE REGULATORY AND OTHER DEVELOPMENTS RELATED TO CLEAN TRANSPORTATION WORLDWIDE.

China's Ministry of Industry and Information Technology (MIIT) last month released its proposed implementation rule for the China Phase 3 new passenger car fuel consumption standard (GB 27999-2011).[1] In contrast to other countries, where standard values, flexibilities and accounting, and compliance and enforcement systems are often integrated into one rulemaking, China's passenger car fuel consumption standard comprises three separate rules. The first, in 2011, specified the standard values (GB 27999-2011). The second, finalized in June 2012, established the accounting method.[2] This final proposal, released on May 7, 2014, deals with implementation and enforcement aspects of the standard.

This proposal signals that China has finally completed the chain of corporate-average fuel consumption regulations for passenger cars for 2015, and the fleet-wide target of 6.9L/100km in 2015 is now firmly established.

The proposed rule, which is notably brief, lays out a suite of measures to ensure manufacturer compliance. (An unofficial translation of the proposal is provided below.) It is possible that MIIT will issue updated implementation guidance with fuller details at a later time. The main elements of the implementation proposal are as follows:

- MIIT will publicly name manufacturers whose corporate-average fuel consumption (CAFC) levels exceed China's 2015 fleet-wide target 6.9L/100km, even if the manufacturer meets its individual CAFC target, as determined by its corporate-average fleet weight.
- MIIT will effectively ban the production (by not processing type-approval certificate application) of new models that cannot meet their specific weight-based Phase 3 standard targets in the next year, if a manufacturer failed its CAFC target for the current year.
- Manufacturers that fail to meet their specific annual CAFC targets will be required to submit a feasible improvement plan to the regulatory agency, specifying detailed steps they will take to come into compliance, including stopping production of vehicle models that exceed their weight-based Phase 3 standard targets.
- OEMs must recalculate their CAFC after counting in the expected sales from a proposed plant expansion or new plant. MIIT will not approve construction of a new plant or expansion of an existing OEM plant if the recalculated CAFC does not meet the OEM's targets.

1 Source: http://zbs.miit.gov.cn/n11293472/n11295142/n11299183/15988682.html

2 Source: http://chinaafc.miit.gov.cn/n2257/n2783/c86526/content.html

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- Limited manufacturer pooling is allowed for the purpose of meeting the CAFC targets. Car manufacturers within a Chinese auto group (First Auto Works, SAIC motor, etc.) may pool together if the auto group has actual and absolute control over each individual manufacturer. However, the proposal does not define what "actual and absolute control" means, so manufacturers may take advantage of this ambiguity and reduce their compliance burden by merging with their "brother" manufacturers instead of truly improving fleet fuel efficiency.

CHINESE AUTO GROUPS

The Chinese auto groups are state-owned or private companies that hold shares in a number of individual auto manufacturers. The four biggest auto groups in China, SAIC Motor, First Auto Works (FAW), Dongfeng Motor, and Chang'an Motor, are all state-owned. Total annual new passenger car sales by those four auto groups in 2012 represented nearly 70% of the entire market that year. Following years of growth, these giant companies each own or partially own dozens of vehicle, engine, and parts manufacturers, along with other types of auto-related enterprises. For example, FAW owns 100% of three light and heavy-duty vehicle manufacturers, and holds shares in another 10 major vehicle or engine manufacturers. Under these major stock-sharing manufacturers, some have one or two more levels of sub-companies.

The nature of many of these subsidiary manufacturers as joint ventures makes the auto group investment relationships complicated. Beginning in the 1980s, China's top leadership made a decision to open the Chinese market to the world. One major impact has been the formation of hundreds of joint-venture auto companies. To prevent the foreign automakers from dominating the infant Chinese car industry, the Chinese government required that the foreign automakers could hold only up to 50% of the total capital of a joint venture. In addition, each foreign automaker can join with up to two domestic auto companies. As a result, each of the big Chinese auto groups can form a number of subsidiary joint-venture companies with various foreign automakers.

The FAW stock-share chart below illustrates the complexity of the relations between the auto groups and their subsidiary companies.

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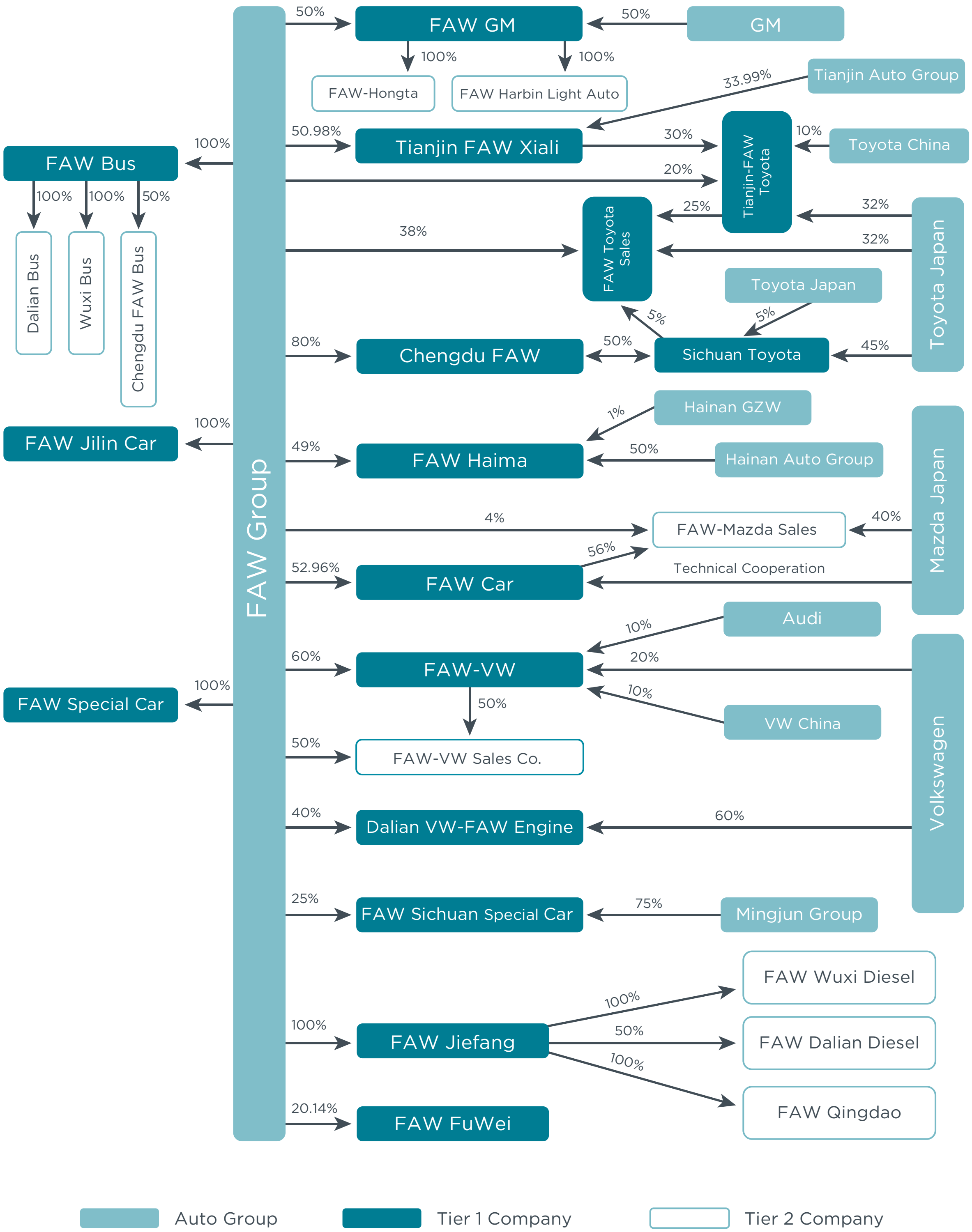

The capital relations of main automakers by the end of 2011

Source: CATARC & CAAM. China Automotive Industry Yearbook (2012).

It is noteworthy that, due to lack of legislative authority, the regulatory agency in China currently cannot impose fiscal penalties on noncompliant manufacturers. This makes China the only major auto market worldwide with only non-fiscal penalties under the vehicle fuel efficiency regulations. The table below summarizes the regulatory enforcement mechanisms in six major auto markets.

Region	Enforcement scheme		
	Fiscal: Penalty for excess emissions	Non-fiscal: Revoke type-approval certificate	Non-fiscal: publish name of manufacturer
US	x	x	
EU	x		
Japan	x		x
Canada	x	x	
China		x	x
S. Korea	x		

Enforcement measures proposed in China incorporate successful elements from regulations in the US, EU and Japan, tailored to fit the Chinese context. Specifically, Provision 2, banning production of noncompliant new models, is conceptually similar to the conditional vehicle type-approval certification used by the US EPA in enforcing criteria pollutant and CO2 emissions standards.

There are practical differences in how production is banned. First, in the US, if a manufacturer cannot meet its corporate-average GHG emissions standard after applying all the flexibilities and credits, EPA will void the certifications of relatively high-emission models until the recalculated corporate-average GHG level does meet the standard. In the Chinese proposal, MIIT will void certification for models that do not meet their specific weight-based fuel consumption target. Second, in the US, EPA may assess a fiscal penalty up to $37,500 for nonconforming vehicles whose type-approval certificates have been revoked. In China, the voided models cannot be produced in the next year, and there is no associated fiscal penalty.

Other elements borrowed from international practice include manufacturer pooling, from the EU car CO2 regulation, and publicly naming noncompliant manufacturers—"name/shame," as it is sometimes called—from the Japanese car fuel-efficiency regulation.

Overall, the proposed enforcement plan is a creative and effective solution to the problem of not being able to impose fiscal penalties on noncompliant manufacturers in China. In fact, this should encourage manufacturers to ask the government to give the regulatory agency the ability to impose fiscal penalties, which would be less disruptive to the manufacturers than banning production of certain vehicles.

UNOFFICIAL TRANSLATION OF THE MIIT IMPLEMENTATION PROPOSAL[3]

1. MIIT will announce to the public the manufacturers whose CAFC levels fail to achieve their CAFC targets and exceed 6.9L/100km after accounting for new energy vehicles.
2. If a manufacturer fails to meet its specific CAFC target in the previous year, MIIT will not accept vehicle model fuel-consumption type-approval applications for models that exceed their weight-based fuel consumption limits specified in GB27999-2011 (Phase 3 standard).
3. New manufacturers or existing manufacturers with expansion plans are required to submit fuel-consumption standard compliance plans to MIIT. If the projected CAFC cannot meet the manufacturer's specific CAFC target for the relevant compliance year, MIIT will not approve the manufacturer's launch or expansion plans. If an existing manufacturer did not meet its specific CAFC target in the previous year, MIIT will not accept its expansion plans.
4. Incorporate fuel consumption standards in the newly amended Chinese Vehicle Compulsory Certification system to assure implementation.
5. Reinforce the investigation of manufacturers that do not meet CAFC standards at all stages including custom entrance, import product examination, conformity testing etc.
6. Manufacturers should strictly follow the requirements in the accounting rule and submit CAFC reports on time. Manufacturers that do not meet their specific CAFC targets in the previous year must submit improvement plans specifying improvement target and measurements, including stopping or limiting the production of models that do not satisfy the standard on a per-vehicle basis, as mentioned in #2 above.
7. Individual manufacturers that are under and are actually managed and operated by the same auto groups, after MIIT and relevant agencies' approval, may pool together to meet a joint CAFC target.

3 Original online at http://zbs.miit.gov.cn/n11293472/n11295142/n11299183/15988682.html