

Box 4

THE EFFECTS OF VEHICLE SCRAPPING SCHEMES ACROSS EURO AREA COUNTRIES

In recent months, fiscal policies have focused on short-term measures to contain the impact that the financial market turmoil has had on the real economy. Specific vehicle scrapping schemes have been implemented in many euro area countries in order to support production in the automotive industry. This box presents an overview of the measures taken in various euro area countries and discusses their potential economic impact.

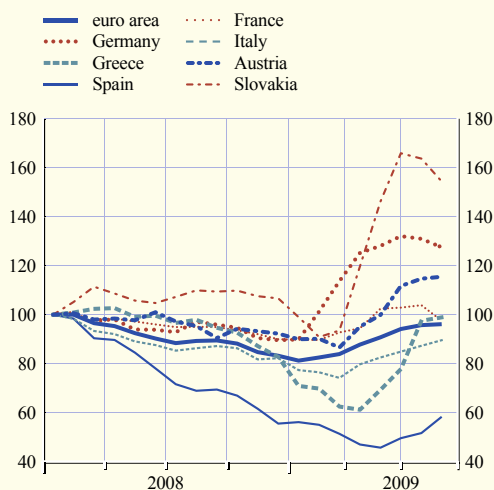
The automotive industry represents a considerable part of the euro area economy, featuring strong interlinkages with other important industries along the value chain. Having been exposed to a weakening in demand, in particular for commercial vehicles, since the beginning of 2008, it has been among those hardest hit by the financial turmoil and the severe economic downturn. Across the euro area, 11 countries have so far implemented or are about to implement vehicle scrapping schemes to soften the impact of the downturn.¹ The first such schemes were implemented in December 2008, and most schemes are planned to last until the end of 2009, or in a few cases until September 2010. Financial support to consumers is typically conditional on the scrapping of old cars and/or the purchase of new or nearly new vehicles, which are generally less harmful to the environment. The budgetary cost of these car scrapping schemes is expected to amount to less than 0.1% of GDP in the euro area as a whole in 2009-10.

The measures appear to have been successful insofar as they have supported short-term demand for new cars. As can be seen from Chart A, new car registrations in the euro area have risen markedly during the course of 2009, rebounding from a decline in 2008. New car registrations rose most strongly in Germany, Austria and Slovakia during the first eight months of 2009, reflecting relatively strong incentives in these countries. The upward impact of these fiscal stimulus measures on demand for new cars has not been strong enough, however, to compensate for the decline in overall demand for cars in the euro area, resulting in particular

¹ For detailed information, see: ACEA (European Automobile Manufacturers' Association), "Overview of vehicle scrapping schemes in the EU", 26 August 2009, http://www.acea.be/images/uploads/files/20090826_Fleet_renewal_schemes.pdf.

Chart A New passenger car registrations in selected euro area countries

(indices of three-month moving averages; January 2008=100; seasonally and working day-adjusted)



Sources: ACEA/A.A.A. and ECB calculations.
Note: The latest data are for August 2009.

or upgraded such schemes more recently, such as Greece, Spain and the Netherlands. Given the high import share of car demand and the fact that the car scrapping schemes have been designed in such a way as to avoid discriminating against foreign car producers, it can also be expected that rising car registrations in individual countries will have led to rising car imports from other countries. Evidence of such spillover effects has been reported for Germany, where car imports surged by 11.5% between January and May 2009, reflecting in particular imports of relatively small and less expensive cars from France, Italy, Slovakia and Romania.² Altogether, the short-term impact on euro area real GDP growth in the first half of 2009 is likely to have been positive, albeit relatively small.

Indeed, the vehicle scrapping schemes also have some immediate and future adverse effects on activity, which need to be taken into account when assessing the overall impact of these measures. First, demand for other major purchases (such as new furniture, but also car repairs) is being dampened owing to both the direct impact of car purchases on households' budgets and the distortionary impact on relative prices. To the extent that new car purchases have crowded out other major purchases, the impact of the measures on private consumption and overall economic activity is less than the direct impact on new car sales. The importance of such a crowding-out effect can be seen from Chart B, which shows quarterly real private consumption growth and the contributions from retail sales (except sales of motor vehicles and motorcycles), car sales (as measured by new car registrations) and other expenditure. In the first half of 2009 it appears that the positive contribution from car sales was to a large extent compensated for by a corresponding negative contribution from other purchases.³

² See Destatis, "Erste Bilanz nach Einführung der Umweltprämie", Pressemitteilung No 302, 17 August 2009.

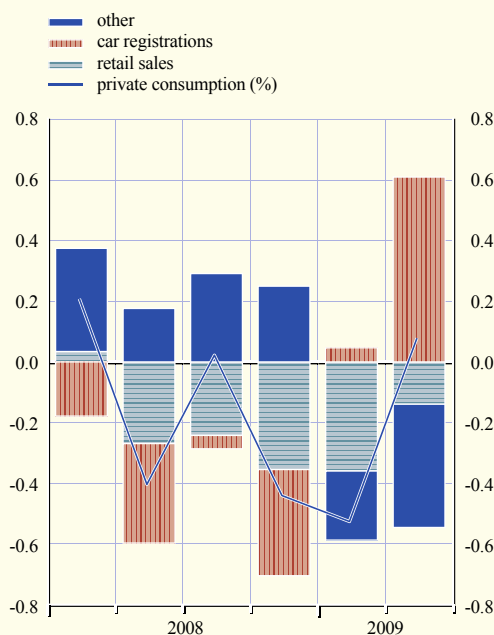
³ An important caveat to such calculations is that the car scrapping schemes appear to have changed the structure of car sales towards smaller and cheaper cars.

from declining foreign demand for new cars. The output of manufacturers of motor vehicles, trailers and semi-trailers continued to decline sharply during the first half of 2009, and in the euro area was down by 31.1% year on year in the second quarter of 2009. In this context, it should be noted that part of the fiscal stimulus has not been effective insofar as some households would have needed to replace an old car even in the absence of the premium and have therefore realised windfall profits.

At the macroeconomic level, there is some evidence that rising car registrations had an upward impact on private consumption in the first half of 2009 in the euro area as a whole. The effect has been pronounced in a number of countries which implemented such schemes at a relatively early stage, in particular Germany, France, Italy and Austria. Some upward impact is expected to be seen in the second half of the year in countries which have implemented

Chart B Euro area private consumption and its main components

(quarter-on-quarter growth rate and quarterly percentage point contributions; seasonally and working day-adjusted)



Sources: Eurostat and ECB calculations.

Second, a negative impact on demand for new cars can be expected once the measures have been phased out. The car scrapping schemes lower the price of current as opposed to future car purchases and thereby lead to a frontloading of private car purchases. The more car purchases have been brought forward into 2009 as a result of the measures, the stronger this unwinding will be. In surveys for Germany, around half of the respondents report that they have brought forward car purchases into 2009 owing to the premium. In such a case, a substantial weakening of car demand might be expected in early 2010.⁴ To the extent that the vehicle scrapping premium has lowered the average age of the car fleet, an adverse effect on new car demand will also prevail in the medium term. In addition, if private households reduced their savings or increased their borrowing to finance their new car purchases, a negative impact on future overall private consumption growth can be expected to the extent that private households need to reduce their borrowing and increase savings again.

Finally, from a more general policy perspective, it should be borne in mind that fiscal measures that benefit a specific industry cause relative price distortions which may prevent necessary structural adjustments, lead to increased pressures from lobbying groups to introduce additional subsidies and distort the level playing field for international competition. Moreover, the early destruction of cars that are still in working order as a result of fiscal incentives to private households reduces the economic wealth of an economy.

All in all, the vehicle scrapping schemes in euro area countries appear to have provided significant support to car production in the first half of 2009 and are expected to continue to do so in the second half of the year (albeit the largest impact on quarterly growth rates may have been seen in the second quarter). However, the upward impact on overall euro area activity in 2009 is likely to remain rather limited and may turn negative in 2010. In general, given their distortionary effects, such measures should be implemented with caution, as they may hamper the efficiency of the functioning of a free market economy and may delay necessary structural change, thereby undermining overall income and employment prospects in the longer term.

⁴ See Rheinisch-Westfälisches Institut für Wirtschaftsforschung, "Die Konjunktur im Inland", *Konjunkturbericht 2009-2*, September 2009, pp. 51-53.