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Expert Analysis

Cash-for-Clunkers Program: Better for Industry Than Environment

By **Michael B. Gerrard**

On June 24, President Barack Obama signed into law the Consumer Assistance to Recycle and Save Act of 2009 (CARS).[1] For a limited period of time, it will give up to $4,500 to owners of vehicles with poor fuel economy who trade them in for more efficient new vehicles. This "cash-for-clunkers" program was touted as meeting three objectives: increasing vehicle sales, at a time when the U.S. auto industry is struggling; reducing fuel use; and reducing greenhouse gas emissions.

This column will describe how the new program will work and what kinds of vehicles can be turned in and purchased under it. It will then assess how well the program, as enacted by Congress, meets its stated objectives.

How the Program Works

The program is now being set up by the National Highway Traffic Safety Administration (NHTSA). The statute gives NHTSA until July 24 to have everything in place. Though the statute makes transactions on or after July 1 potentially eligible, it probably makes sense to wait until the program is formally in place. The program expires the earlier of Nov. 1, 2009 or whenever the $1 billion Congress appropriated for it is exhausted.

Auto dealers must register with the NHTSA in order to participate. Registered dealers will be listed at www.cars.gov. A consumer wishing to use the program should go to a registered dealer with title, registration, and insurance papers showing continuous registration and insurance coverage for the past full year. The consumer may then buy or lease a new vehicle from the dealer. The dealer gives the consumer a credit of either $3,500 or $4,500, depending on the factors described below. The dealer submits the required documentation to the NHTSA, which verifies that all the program requirements have been met and then issues a financial credit to the dealer. Consumers will not receive vouchers or money directly from the government.

The dealer must make sure that the old car is crushed or shredded—to keep it on the road would defeat the purposes of the program (though certain parts may be removed and sold). Thus the consumer will not receive any trade-in value beyond the government credit, but may negotiate with the dealer over the scrap value. This also means that use of the program makes sense to a consumer only if the trade-in value is less than the government credit.

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The credit is in addition to any rebates or discounts advertised by the dealer or offered by the new vehicle's manufacturer; the dealer may not use the credit to offset these rebates and discounts. The credit can be combined with other state and federal incentives, such as the hybrid vehicle credit. No more than one credit may be issued to a single person. Dealers may not charge consumers an extra fee for using the program.

The statute provides that the credit is not taxable income for the consumer, but is income for the dealer.

Eligible Vehicles

Under the new law, the trade-in vehicles must:

- Have a combined city/highway fuel economy of 18 miles per gallon or less;
- Be in drivable condition;
- Have been continuously insured and registered to the same owner for the full year proceeding the trade in; and
- Have been manufactured less than 25 years before the date traded in. (Other than this, the age of the vehicle does not matter.)

Work trucks (i.e., very large pickup trucks and cargo vans) have different requirements.

A vehicle's fuel economy can be found at www.fueleconomy.gov;[2] look up the make, model and year, and check the "combined" number under the words "Estimated New EPA MPG." The month and year of manufacture are typically shown on a label on the frame or edge of the driver's door.

The new vehicle must:

- Have a manufacturer's suggested retail price no greater than $45,000;
- Have a combined fuel economy value of at least 22 mpg, if it is a passenger car. If it is a category 1 truck (e.g., sport utility vehicles, small and medium pickup trucks, and small and medium passenger and cargo vans), the minimum is 18 mpg; for larger vehicles, still lower mileage is required; and
- Really be new; used vehicles are not eligible.

The new vehicle does not have to have been made in the U.S. (World Trade Organization problems could result otherwise.)

Value of Credit

The value of the credit depends on how much better the fuel economy of the new vehicle is than that of the old one. For passenger vehicles, the credit is $3,500 if the new vehicle has a combined fuel economy that is 4-9 mpg higher than the old

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vehicle; and it is $4,500 if the new vehicle is at least 10 mpg better than the old one.

For SUVs, pickups, and larger vehicles, the rules are more complex for what combination of old and new vehicles receives what size credit. The details can be found at www.cars.gov. For some combinations, a difference of just 1 mpg entitles the consumer to a credit of $3,500.

The combination of requirements means that the program is attractive only to consumers who have vehicles that are no longer worth much (or else the credit is worth less than the trade-in) and that have poor fuel economy (or else they are ineligible). A recent-model large car with terrible fuel economy is probably worth more than the credit, and a very old but small car probably has a fuel economy that does not meet the eligibility threshold. Thus the vehicles that are mostly likely to be turned in under the program are trucks. Consumer Reports released a list of the "best gas guzzlers to junk;" 22 of the 32 vehicles listed are trucks.[3]

Adoption of the Law

The United States is a latecomer to adopting a "cash for clunkers" program. According to the European Automobile Manufacturers' Association, 11 countries in the European Union have such programs.[4] Unlike the program adopted here, they are for the most part based on vehicle age; they typically require the old vehicle to be at least 10 years old. For the most part the incentive ranges from 1,000 to 1,750 euros, though in Germany and Italy it is considerably higher.

The State of Texas also has a program that is open to cars or trucks that are at least 10 years old or have failed an emissions test. In order to participate, the vehicle owner must have a net income below a set amount (based on size of household) and the vehicle must be registered in certain listed counties in or near Austin, Dallas-Fort Worth, or Houston.[5] Programs with different requirements have also been adopted in California and in Canada.

The U.S. House of Representatives passed cash for clunkers as a standalone bill on June 9. The program would have gone on a year, and $4 billion was allocated for it. However, the bill faced stiff opposition in the Senate. Many senators felt the concept was too generous to the auto industry. Even some senators who favored the concept thought the required mpg differential between old and new vehicles was too small. Senators Dianne Feinstein (D. CA) and Susan Collins (R. ME) called it a "Handouts for Hummers" program, showing that the House bill would subsidize the purchase of a new Hummer H3T or a new Dodge Ram 1500 4x4 truck, depending on what kind of vehicle was turned in.

Seeing this opposition, the House proponents attached the program to a supplemental appropriations bill that was chiefly to fund the wars in Iraq and Afghanistan, operations in Pakistan, and initiatives to combat the flu pandemic. The size and duration of the cash-for-clunkers provision were pared back; instead of a full year, it became a four-month program, and instead of $4 billion, just $1 billion was provided. With these revisions, the supplemental appropriations bill was approved by the House-Senate conference committee. It then quickly passed the House. Efforts led by Senator Judd Gregg (R. NH) to block the cash-for-clunkers portion failed in the Senate, and the law achieved final approval in the Senate on June 18. President Obama signed it a week later.

A program that encourages old cars to be crushed and shredded rather than traded in may reduce the supply of used cars, and thus would presumably raise the price of those that remain. This would hurt lower-income people.

Impacts

The program that was passed by Congress will chiefly benefit the vehicle manufacturers. Such a narrow differential in mileage between traded-in and new vehicles is eligible for the credit that the resulting reductions in fuel usage and greenhouse gas emissions will be modest. Moreover, as has been pointed out by Bill Chameides, dean of the Nicholas School of the Environment at Duke University, the energy cost of building new vehicles must be factored into the equation. Between 3.5 and 12.5 tons of carbon dioxide are emitted in the manufacture of a new vehicle, or an average of about 6.7 tons. The carbon dioxide payback time—the time it takes for the fuel savings from use to overtake the fuel cost of making the new vehicle—will of course vary with the number of miles driven as well as the mpg differential of the old and new vehicles, but it can take several years.

The program also affects income distribution. People who buy used cars typically have lower incomes than people who buy new cars. A program that encourages old cars to be crushed and shredded rather than traded in may reduce the supply of used cars, and thus would presumably raise the price of those that remain. This phenomenon would hurt lower-income people more than those with upper incomes.[6] On the other hand, if the program succeeds in increasing vehicle sales, that could increase auto industry employment (or at least moderate its declines).

1. Title XIII of the Supplemental Appropriations Act, Public Law 111-32, 123 Stat. 1859.

2. The NHTSA will also be making this and other pertinent information available at www.cars.gov, and by telephone at 1-866-CAR-7891.

3. http://blogs.consumerreports.org/cars/2009/06/cash-for-clunkers-the-best-gas-guzzlers-to-junk.html.

4. ACEA, "Vehicle Scrapping Schemes in the European Union," April 6, 2009, http://www.acea.be/images/uploads/files/20090406_Scrapping_schemes.pdf.

5. Texas Commission on Environmental Quality web site, www.driveacleanmachine.org.

6. Susan Shaheen et al., "Vehicle Scrappage Programs: Are Some Sectors of Society Paying More For Clean Air" (1994), http://pubs.its.ucdavis.edu/publication_detail.php?id=817. See also American Council for an Energy-Efficient Economy, "Accelerated Retirement of Fuel-Inefficient Vehicles Through Incentive for the Purchase of Fuel-Efficient Vehicles" (Jan. 13, 2009), http://www.aceee.org/transportation/Crusher%20white%20paper%20fin.pdf.