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Obama's Automotive Fuel Standards Must Go

By Jerry Taylor and Peter Van Doren

Lost in the hysterics regarding America's near plummet off the face of the fiscal earth earlier this month was President Obama's announcement that new automobiles sold in 2025 would have to average 54.5 miles per gallon (mpg). Presently, fuel efficiency averages about 27 mpg. Can it be done? Probably. Should it be done? Probably not.

The reason such a large increase is even possible is because of the truly revolutionary advances in automotive computerization that have occurred since 1980. Energy economist Christopher Knittel reports that had all of those advances been used to increase fuel efficiency (and weight, horsepower, and torque were held at their 1980 levels), fuel efficiency would have been 50% greater in 2006 than in 1980.

Alas, computerization was not primarily used to improve fuel efficiency. It was used to increase — you guessed it — weight (12% for cars and 26% for light trucks) and horsepower (80% for cars and 99% for light trucks), so fuel efficiency improved by only about 15%. Hence, automakers could meet the Obama standard of 35.5 mpg by 2016 by either going back to the 1980 mix of trucks and cars (20% light trucks instead of around 50%) and reducing the weight and horsepower gains since 1980 by 25% ... or by keeping the current mix of cars and trucks and returning to 1980 standards for weight and horsepower.

But how might we get from there to 54.5 mpg by 2025? A mix of continued technological innovation — all devoted to fuel efficiency — and creative accounting ought to do the trick. The new regulations proposed by President Obama are mind-numbingly complex. The least you need to know is that vehicles powered partially or fully with electric batteries, fuel cells, and various alternative fuels give automakers bonus fuel efficiency credits. That is, they are deemed more fuel efficient, for regulatory purposes, than they otherwise are. Sell enough of these and the standards will be reached.

How much might all this cost? Who knows? The administration itself suggests that the new rules would increase average new car purchase prices by up to \$2,500, but in truth, they're simply guessing about the price path of technological innovations, many of which have yet to spring from the human brow. The same goes for the administration's claim that these new rules will save the nation \$1.7 trillion on gasoline costs through 2025. That's because we haven't the faintest idea what gasoline will cost in the next several months, much less over the next 14 years.

Econometrician James Hamilton's close examination of oil price trends since 1970 finds that oil (and thus, gasoline) prices are extremely volatile — something we all know too well — but exhibit no trend. Instead, price movements are best characterized as “a random walk without drift.” Under high price scenarios, the rules might pass a cost-benefit test, but under low price scenarios, they would not.

We can be reasonably sure, however, that the cars of the future will be very different than the cars of the present if these new rules are enforced. That's because the reverse engineering that Knittel describes will almost certainly shock a lot of Americans by seriously degrading on-the-road performance that we all take for granted.

The New York Times, for instance, reports that one of the classic muscle cars of the 1970s — the 1975 Pontiac Firebird Trans Am 400 — could go from 0 to 60 in 9.8 seconds. By comparison, the lowly 2005 Toyota Camry XLE V6 can do the same in 8.1 seconds. Likewise, a 1965 Mustang convertible has about the same accelerating power as a lumbering, 2001 Jeep Grand Cherokee. A return to the performance standards of the mid-1970s will most certainly not go unnoticed — or welcomed.

So why are we doing this? Even if the administration's cost-benefit analysis is correct, it only passes muster if on-road performance has little or no economic value to you. How does the government know what car buyers value?

Moreover, even if the administration's assumptions about consumer preferences are correct, do we really need the government to make us save money? Why not also ban the sale of all but bulk-purchases of food items and other household purchases? Mandate car pooling a few days a month? If you want to save money on gasoline bills, there are plenty of ways for you to do so right now; no government program is necessary.

What this is really about is a federal attempt to ban the trade-offs that most of us (but not all of us) make when we periodically go into the market for new automobiles. This is rationalized by the claim that consumers will not pay more initially for a car that will save them operating expenses over time because of irrationality or inability to compare a flow of future savings with an initial up-front cost.

But economist Molly Espey found that consumers' willingness to pay for extra fuel economy for 2001 model cars (when fuel prices were still low) equaled or exceeded the present value of lifetime estimated savings. More recently, Antonio Bento and his coauthors concluded that the repeated finding by other economists that consumers will pay much less than a dollar (\$0.35 to \$0.79) for a dollar's worth of future discounted fuel costs may be the result of mistakes in econometric modeling. When those errors are corrected, the unwillingness of consumers to pay a dollar for a dollar's worth of savings in present value disappears.

The fall-back argument for these standards is that gasoline costs impose significant environmental and national security costs on society that aren't reflected in fuel prices. We're skeptical of these arguments, but even if they are correct, the best method

of addressing those externalities is to increase the gasoline tax rather than increase fuel economy standards.

There are several reasons for this. First, all drivers should bear their external costs, not just new car buyers in the future. Second, improving fuel efficiency reduces the marginal cost of driving, which will lead to ... more driving. Finally, fuel economy standards are an expensive method of improving fuel economy. It costs three times more to reduce fuel consumption with an increase in the CAFE (corporate average fuel economy) standards than with a simple gasoline tax.

Automotive fuel efficiency standards have a well-earned spot in most economists' "top-10" list of bad or sub-par regulations. Adding more muscle to those regulations will only move CAFE standards up that list even higher.