

Case Study #4

Cash for Clunkers

On June 24, 2009, President Obama signed into law the Consumer Assistance to Recycle and Save (CARS) Act, better known as the “cash-for-clunkers” program. The measure appropriated \$1 billion to pay from \$3,500 to \$4,500 to each car buyer who traded a “clunker,” or an older car with gas mileage of 18 miles per gallon or less, for a new one with better gas mileage. The clunker had to be “drivable,” and registered and insured by the same person for at least a year prior to the sale (to prevent someone from buying a junk just as a trade-in).

Once car dealers began submitting paperwork for government reimbursement, it became clear the program would soon burn through the \$1 billion appropriation. So Congress put \$2 billion more into the pot and limited the program to a month (the \$1 billion was originally expected to last four months). The 135 pages of government rules were constantly changing, and the Web site dealers used often crashed. The 2,000 people needed to process paperwork had trouble reimbursing dealers, so some dealers had to drop out of the program.

Still, nearly 680,000 new vehicles were sold during the month of the program. That spike in sales, some argue, is clear evidence of the program’s success. For example, the Transportation Secretary claimed this “is the one stimulus program that seems to be working better than just about any other program.” And the program’s Web site said it was “wildly successful.” But evidence suggests that the overwhelming majority of those car sales would have occurred anyway during the last half of 2009. For example, according to analysis by the automotive Web site Edmunds.com, which tracks car sales, the net effect of the program was only 125,000 additional vehicle sales, implying a government cost of \$24,000 per additional sale.

But even if the program was expensive on a per vehicle basis, didn’t the economy in general and car makers in particular need a boost? First, the \$3 billion spent on the program was money the government didn’t have; the outlays increased the federal deficit, already at record levels. Ultimately, to pay for the program, taxes must be raised or other government spending must be cut. Second, at least some of the stimulus benefited other economies. Japanese manufacturers accounted for 41 percent of the program sales and the Big Three (General Motors, Ford, and Chrysler), 39 percent. Third, automakers already received the \$83 billion in bailout funds (and at least \$34 billion would not likely ever be repaid). What about helping other sectors hit hard by the recession such as furniture makers and the travel industry? Why not “cash for couches” or “cash for cruises”?

Proponents of cash for clunkers would point out that cars are a special case, because a second objective of the program was to clear the air by replacing clunkers with cars that would get maybe 10 more miles to the gallon. Christopher Knittel of the University of California, Davis, estimated that the government could have gotten 10 times more carbon reduction by spending the \$3 billion in the market for carbon offsets.

For most buyers, the clunker money served as the down payment on a new car, so more people could afford one, and didn’t that stimulate the economy? From that stimulus effect must be subtracted the housing, furniture, clothes, vacation trips, and other items that those consumers wouldn’t be buying in the future, because they face additional monthly payments for car leases or car loans. Finally, by mandating the destruction of each trade-in vehicle (a disposal facility had to crush or shred each clunker with evidence of such supplied to the government), Congress removed up to 680,000 drivable cars from the used-car market, inevitably raising the prices of the used cars that low-income households tend to buy. The destruction also reduced the supply of salvageable used parts that are bought mostly by low-income drivers looking to keep their cars running. Cash for clunkers was never that popular with the public. Polls show that most Americans did not approve of the program.

Sources: Emily Maltby, “Used Car Dealers Feel Clunkers Pinch,” *Wall Street Journal*, 6 October 2009; Irwin M. Stelzer, “Seven Lessons of Cash-for-Clunkers Failure,” *Washington Examiner*, 28 August 2009; Christopher R. Knittel, “The Implied Cost of Carbon Dioxide Under the Cash for Clunkers Program,” Working Paper (31 August 2009) at http://www.econ.ucdavis.edu/faculty/knittel/papers/CfC_final_latest.pdf; and the government program’s site at <http://www.cars.gov/>.

¶ The move follows a scramble Thursday after it emerged that the initial \$1 billion allocated to the clunkers program may have been close to exhausted after just one week. The legislation would

shift \$2 billion from the \$787 billion stimulus plan to the program.

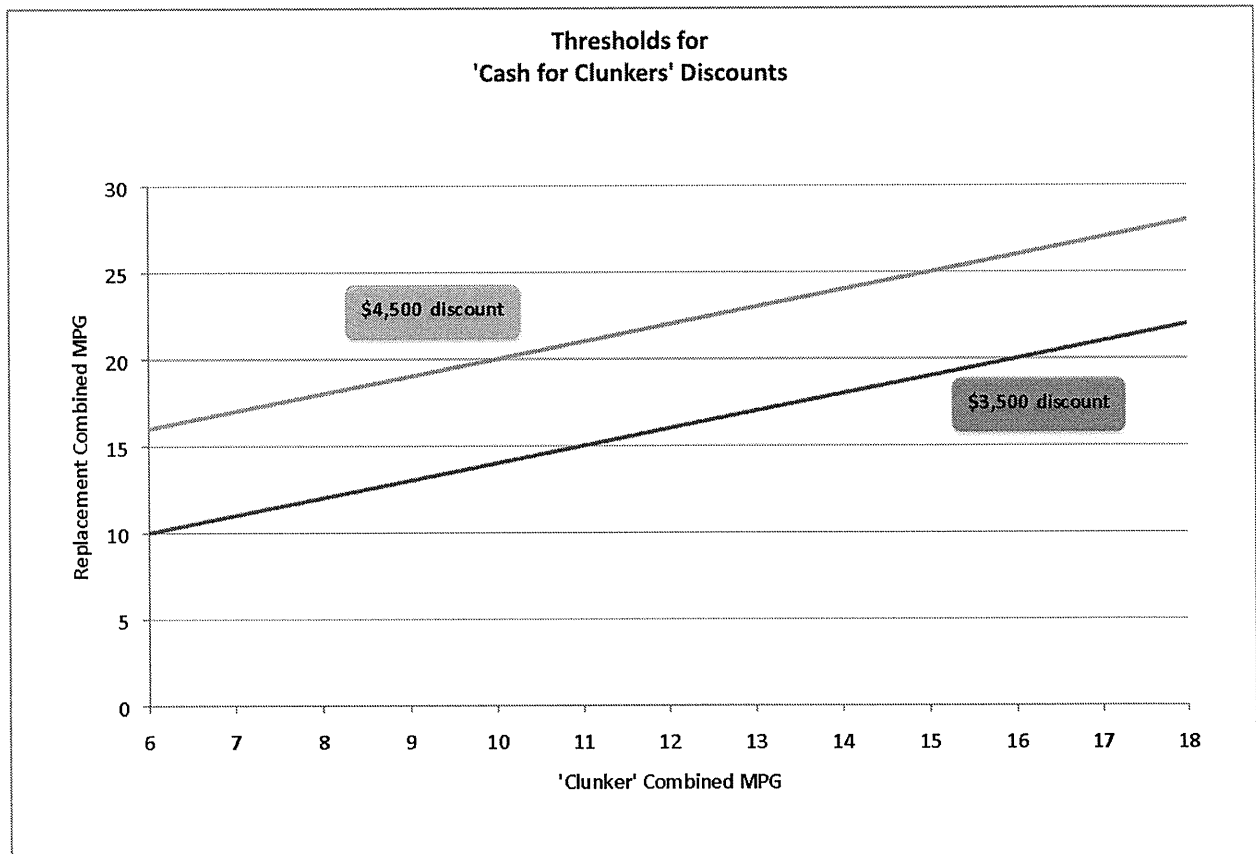
The House voted 316 to 109 to approve the extension. Because the measure was placed on the suspension calendar, it required two-thirds of lawmakers' support to carry it.

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As of Friday morning, the National Highway Traffic Safety Administration, which is handling the clunker rebates, has processed \$250 million in vouchers,

The current program offers buyers a \$3,500 discount for replacement cars getting 4 mpg more in combined fuel economy and \$4,500 for a 10 mpg increase. Only vehicles currently getting a combined 18 mpg or less qualify as "clunkers." (Rules for trucks are different.)

The chart below shows what a replacement car must achieve to be entitled to each of the two discounts. While the government has been surprised by consumer response, data are not yet available indicating what choices consumers have made. Many new vehicles can qualify as replacements under the 4-mpg improvement threshold, but few qualify under the 10-mpg improvement threshold unless the "clunker" happens to be located way to the left side, perhaps with single-digit mpg.



President Obama has expressed support for replenishing funds for the program. Prospects in the Senate are less clear, however, because those who opposed the original bill on the ground that it was demanded too little improvement in fuel economy may want to reopen debate about the program's design.

This would expose a rift between two competing policy objectives. Some advocates wanted to use the program to significantly change consumers' energy consumption, such as by replacing a low mpg car with one that gets very high mpg. Others wanted to stimulate auto sales generally. As designed, the program is a compromise between these two goals. It appears that the program has stimulated sales, though it may be the case that many consumers delayed making purchases they otherwise would have made, in order to take advantage of the program. The extent to which it has changed participating consumers' fuel consumption cannot be ascertained at least until program data are available to see what decisions consumers have made. Even then, only a preliminary conclusion is feasible because there won't be any data indicating the extent to which replacement vehicles are driven more miles than the clunkers the program removes from the fleet.

Government's Cash for Clunkers Top Ten List Gets It Wrong

By Robert Farago on August 7, 2009



The autoblogosphere is abuzz with debate over the Department of Transportation's (DOT) list of the top ten Cash for Clunking vehicles. To say the least. Edmunds [via CNN] reports that the DOT counted

vehicles EPA-style, tallying differing powertrain or drive wheel combinations separately. For example, the DOT rates a Ford Escape with two wheel-drive as a distinct model from a Ford Escape with all wheel-drive. If you're Edmunds (or any one else with an ounce of common sense), you combine all the model variants' sales totals into one stat. And if you do *that*, you get a horse of a different color. The implication making the rounds: the DOT manipulated the data to hide the fact that a brace of SUVs and pickup trucks made the top ten; the Cash for Clunkers program is supposed to be about saving the environment. Yes, well, high margin pickup trucks offer the best chance of saving the domestics. So, let's compare the DOT list (as of August 7) with Edmunds' take . . .

Rank	DOT	Edmunds
1.	Toyota Corolla	Ford Escape
2.	Ford Focus	Ford Focus
3.	Honda Civic	Jeep Patriot
4.	Toyota Prius	Dodge Caliber
5.	Toyota Camry	Ford F-150
6.	Hyundai Elantra	Honda Civic
7.	Ford Escape (FWD)	Chevrolet Silverado
8.	Dodge Caliber	Chevrolet Cobalt
9.	Honda Fit	Toyota Corolla
10.	Chevrolet Cobalt	Ford Fusion

Objective - Explain how the Federal Government stimulates the economy with creative plans.

(ch. 12, 13 + 14)