



By Robert N. Stavins

No Free Lunch at the Auto CAFE

In May, President Obama announced new federal fuel-efficiency standards for motor-vehicles that would make the current standards — known as Corporate Average Fuel Economy — significantly more stringent. These CAFE standards measure compliance as the average of a company's fleet of cars, and so are more flexible and less costly than model-by-model standards, better matching consumer preferences and reducing production costs.

The administration's proposal will yield a single standard nationwide, rather than two fuel efficiency standards, one for California and the other states that chose to follow its more stringent Pavley standards (named after California State Senator Fran Pavley), and another standard for the rest of the country under the existing CAFE program. The result would have been that the states adopting the more stringent California standard would have brought about little incremental benefit for the environment beyond the national CAFE program, because auto manufacturers and importers would have largely undone the effects of the more stringent state-level fuel-efficiency requirements by selling more of the less fuel-efficient models in their fleets in the non-Pavley states. Thus, dual standards would have increased costs, but with little or no additional benefit to the environment.

These new federal standards pro-

posed by the Obama administration can therefore be one small step along the path to meaningful reductions in greenhouse gas emissions that cause climate change. That's the good news. But it's also true that the new standards are inferior to other possible approaches.

First of all, CAFE affects only the cars we buy, not how much we drive them, and so CAFE standards are less cost-effective than gasoline prices at reducing gasoline consumption, because gas prices (whether reflecting market conditions or government taxes) affect both which cars we buy and our choices about driving.

Some people may think that CAFE standards — unlike gas taxes — are costless for consumers. But according to the administration, the increases in CAFE standards (including both scheduled increases already on the books and the new Obama proposal) will add on average \$1,300 to the cost of producing a new car.

Because CAFE standards increase the price of new cars, the standards have the unintentional effect of keeping older, dirtier, and less fuel-efficient cars on the road longer. This counterproductive effect is typical of any vintage-differentiated-regulation, a topic which I have previously addressed in this column.

Also, by decreasing the cost per mile of driving, CAFE standards — like any energy-efficiency technology standard — exhibit a "rebound effect," namely, people have an incentive to drive more, not less, thereby lessening the anticipated reduction in gasoline usage.

The bottom line is that gasoline prices are a much more effective — and more cost-effective — means of cutting gasoline demand. But if increasing gasoline prices through gas taxes is politically impossible, which certainly appears to be the case in the current political climate, why raise all of these objections? Am I allowing the

(politically infeasible) perfect to be the enemy of the good? Not at all.

There is, in fact, another policy instrument available that has the same desirable impacts as gas taxes on gasoline prices (and, more importantly, on all other fossil fuel prices, as well), but inspires dramatically less political opposition. And this instrument is not only politically feasible, but has been achieving remarkable political support and action in Washington. I'm talking about the economy-wide CO₂ cap-and-trade system in the House's Waxman-Markey legislation. Their cap-and-trade system will serve to increase the price of gasoline, cut demand, and reduce emissions. But, in addition, its impacts will go far beyond automobiles and trucks, and beyond the transportation sector, as well.

To seriously address climate change, it is essential to put in place a single carbon price that affects all fossil fuels and all uses throughout the economy — not only in the

transportation sector, but also electric power, and the manufacturing, commercial, and residential sectors. This is precisely what cap-and-trade does. A meaning-

ful, upstream, economy-wide cap-and-trade system will serve to increase the price of gasoline, as well as other fuels, electricity, and all goods and services in proportion to their carbon-intensity in production, and it does this in the right proportions for each fuel, energy source, and product, so that the overall cap is achieved at the least possible cost. Put simply, cap-and-trade is the cheapest, best, and only politically feasible approach that can achieve the significant reductions in CO₂ emissions that will be necessary to meet President Obama's ambitious climate goals.

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