

Cash for Clunkers: Boon or Bust?

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In addition to the never-ending discussion of the auto bailout, we are now starting to hear more about a scrappage program brewing in Congress. The program – affectionately called Cash for Clunkers, but formally titled the Accelerated Retirement of Inefficient Vehicles Act of 2009 – at first glance seems like a brilliant solution that will solve problems on many levels. Consumers can trade in older vehicles and receive a voucher toward the purchase of a new, more fuel efficient model. The consumer is happy, the environment benefits because newer cars emit less pollution, less fuel will be consumed, and the car companies will receive a much needed boost in sales. Everybody wins, right? Maybe...or maybe not.

A Brief Look at the Program

According to the bill as it currently stands, consumers will receive a \$3,500 voucher toward the purchase of a new vehicle if the mileage improvement on the new vehicle is at least 2 miles per gallon for a light truck or 4 mpg for a passenger car. A \$4,500 voucher will be provided if the mileage improvement is at least 5 mpg for a light truck and at least 10 mpg for a passenger car. Vouchers are also available for light duty trucks (6,000-8,500 lbs.) and work trucks (8,500 – 10,000 lbs) that achieve a specified increase in fuel economy over the models being traded in. The program would run for a period of one year. The ultimate goal is to increase automotive sales by one million units during that timeframe.

Obstacles to the Program's Success

- There is no incentive in cases where the trade-in value of an older vehicle is greater than the value of the voucher. Drivers who own clunkers with trade-in values less than that of the voucher would benefit, and ironically, these are the drivers that would be less likely to purchase or afford a brand new vehicle.
- The bill could have a detrimental effect on the used car sector and the lower income consumers that populate that market. The aftermarket industry has pointed out that removing older vehicles from the fleet prematurely will place a strain on the availability of repair parts for older vehicles, as well as drive up the cost of used cars due to the resultant decline in supply. The limited pool of available used cars would then make it more difficult for millions of middle and low income families, who cannot afford new cars, to find quality used vehicles and repair parts.
- The bill could potentially place more economic strain on some consumers, as they may be swayed into purchasing a new vehicle when they really should not just because the deal is “too good to pass up.” Conversely, the incentive being offered may not be enough to convince wary buyers into making a purchase when there is still a great deal of economic uncertainty.
- The cars eligible under the program may not work for everyone and / or do not meet the buying criteria of many consumers. Most of the vehicles eligible under the program are smaller cars. While it is no secret that the government wants to move consumers toward the purchase of small, fuel-efficient cars in place of the light trucks and SUVs that were popular in the past, these types of vehicles are not feasible for or desired by all

consumers. With gas prices hovering below \$2.50 a gallon, the trade-in incentive offered by the government plan does not have enough horsepower to encourage owners of older SUVs and trucks to change their behavior and switch to small cars.

- The CFC program will artificially boost sales. The incentives may pull ahead sales that would have happened anyway at a later date, rather than luring a completely new set of buyers into the market. This is the “robbing from Peter to pay Paul” phenomenon, as the buyers that purchase now, will not be purchasing next year.
- The program is not free, as it represents another avenue for spending of American tax dollars. The estimated cost of the program could be as high as \$4.5 billion if it meets the expectations of those that are supporting the bill.

Will it Pass?

While President Obama backs the proposal, the legislation (as of this writing) is attached to the more controversial energy and climate change bill (The American Clean Energy and Security Act of 2009). The climate change legislation does not yet have enough support to make it out of the Energy and Commerce Committee, so it is possible that CFC could be proposed as a separate piece of legislation. The longer the debate wages on, the greater potential damage it is doing to the auto industry – to the extent that the program works – as some buyers may be waiting on the outcome of the legislation before making a purchase decision. The bottom line, however, is that aside from any short-term positive effect the bill may have, it is still a band-aid rather than the long-term solution the industry so desperately needs.