



Consumer Federation of America

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For Immediate Release
July 1, 2008

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Administration Fails To Follow Congressional Mandate *Flouts \$4 a Gallon Gas; Cripples Consumers and Industry*

Washington, DC -- Today, the Consumer Federation of America (CFA) released a detailed analysis of the Administration's failure to meet the mandate of the Energy Independence and Security Act (EISA), passed by Congress late last year.

"Never in the history of this country has it been more important, both domestically and globally, to reduce gasoline and oil consumption, which is why Congress mandated that automakers make cars and trucks that run on less gas," said Jack Gillis, CFA Director of Public Affairs. "Somehow the Department of Transportation didn't get the message. With gas at \$4 a gallon, they use \$2.45 in its analysis. With our oil dollars filling the coffers of nations hostile to our interests, they assign no military cost to oil. With used SUVs lining dealer lots, they claim fuel economy has no impact on vehicle resale value. Each absurd assumption deprives consumers of the fuel economy they want and the nation the fuel savings it needs."

Under the Energy Independence and Security Act, the Department of Transportation's National Highway Traffic Safety Administration (NHTSA) is required to set fuel economy standards at the maximum feasible level. CFA's analysis provides a step-by-step explication of NHTSA's analytical flaws, inaccurate assumptions, lack of data and unreasonable economic considerations that result in proposed fuel economy standards that are "unreasonably low, cover a period that is unreasonably long, and are inadequately documented, meeting neither the spirit nor the intent of the Energy Independence and Security Act."

Combined, these overt flaws in NHTSA's economic assumptions and modeling have led the Administration to value gasoline savings at less than half of what would be a reasonable estimate. Correcting these flaws will result in standards that are substantially higher and save the nation much more energy at a modest economic cost. At a minimum, correcting these errors would increase gasoline savings by approximately 40 percent or just over 21 billion gallons in years 2011-2015. The incremental consumer cost of those savings would be just over \$53 billion or less than \$2.50 per gallon. With gasoline currently at \$4 per gallon, these additional savings would be both a good deal for consumers and the nation.

"The proposed rule is a far cry from the maximum feasible fuel economy standards because NHTSA's model and assumptions are hostile to the very energy conservation it is charged with providing," said Mark Cooper, CFA Director of Research and principal author of the comments.

Based on a 68-page analysis of the proposed rule, CFA outlines three steps for NHTSA to take to bring the proposed standard in line with reality and the intent of Congress:

1. NHTSA should explicitly correct the analytical and empirical flaws in its model and establish clear tests and analytic approaches to evaluate standards, independent of the level at which they are set in any given proceeding.
2. NHTSA should raise the standard by 50% for 2011 and 2012. This level is justified when NHTSA corrects the empirical and conceptual flaws in its analytic framework. It is consistent with the level supported by NHTSA's high fuel price sensitivity case. Even Guy Caruso, head of the Energy Information Administration (EIA) testified before Congress that he would use the higher price of fuel (of about \$3.40 per gallon in 2015) if he were NHTSA.
3. NHTSA should rescind the standards for 2013-2015, complete the gathering of the critical information it needs to make an informed recommendation, and develop recommendations based on that information.

By relying on a flawed analytic framework and mistaken empirical specifications, this rulemaking undermines future rulemakings, CFA charges. Three aspects of the proposed rulemaking would, if not corrected, lock flawed assumptions and modeling into place creating an unrealistically low ceiling for fuel economy for years to come:

- First, once the analytical framework is set, it will be difficult to change. Inertia and judicial deference make it difficult to reverse agency decisions.
- Second, setting a low standard makes it far more difficult for the industry to meet higher future standards. Requiring large jumps in improvements is always more expensive than gradual improvements toward a goal, so fixing the mistakes later is harder because the industry is further behind.
- Finally, as written, there is no need for another proceeding until 2013, when standards for 2016-2020 will have to be written. If the new administration tries to revisit the order sooner, automakers will complain that NHTSA is switching rules in mid-stream and take it to court, as they have in the past.

"If the rule stands as written, fuel economy standards will be hamstrung for years to come, providing neither the fuel economy consumers demand, nor the oil savings our nation needs," said Cooper.

CFA's full comments on NHTSA's rulemaking are available on the web at:

http://www.consumerfed.org/pdfs/nhtsa_comments.pdf

A summary of the comments follows.



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SUMMARY OF COMMENTS

NATIONAL HIGHWAY TRAFFIC SAFETY ADMINISTRATION PROPOSED RULEMAKING

FINDINGS

NHTSA Has Inexplicably Undervalued the Benefits of Increased Vehicle Fuel Economy

In its economic assumptions, NHTSA has chosen to grossly undervalue gasoline consumption and therefore undervalues the fuel savings that will flow from a higher fuel economy standard. To arrive at the proposed rule, NHTSA:

- used gasoline prices that are far too low – a price of only \$2.45 per gallon for 2015 (in 2008 dollars);
- ascribed no military or strategic value to oil, totally ignoring the basis for the Congressional mandate which is underscored with the inclusion of ‘Security’ in the name of the Act;
- assumed that fuel economy has no impact on the resale value of a vehicle, something that every owner of a fuel-inefficient vehicle knows matters;
- discounted the value of fuel savings at an unnecessarily high rate; i.e. after identifying two possible discount rates: 1) a high rate based on the automaker view of capital costs and 2) a low rate based on the consumer view of consumption expenditures; NHTSA failed to choose a rate between the two, instead applying the high “capital” rate;
- assumed that consumers irrationally burn up their fuel savings on increased driving, rather than using it to buy other goods and services, and applied this “rebound” effect to analyses where it should not play a role.

Combined, these overt flaws in NHTSA’s economic assumptions have led the Administration to value gasoline savings at less than half of what would be a reasonable estimate.

NHTSA Failed to Give the “Need to Conserve Energy” Proper Consideration in Light of the Clear, Obvious, and Painful National Energy Crisis Currently Facing All Americans

In speaking for the American public, Congress was very clear in its requirement that NHTSA set the fuel economy standard at the “maximum feasible level.” In doing so, the Administration was to take into consideration “the four statutory factors underlying maximum feasibility (technological feasibility, economic practicability, the effect of other standards on fuel economy, and the need of the nation to conserve energy).” NHTSA completely failed to give proper consideration to this last and most fundamental reason for the Act: “the need of the nation

to conserve energy.” As detailed below, NHTSA has chosen to use an analytic framework that is fundamentally flawed.

- In its analysis, NHTSA identified two extreme economic alternatives. One alternative would maximize fuel savings at no net cost to society, by including fuel savings technologies until the total cost equals the total benefit. The other would maximize the economic return of investments in fuel economy by including fuel savings technology only up to the point where marginal benefits equal marginal costs. A reasonable analysis would have balanced the economic and conservation concerns and set the standard between the two extremes. NHTSA simply chose to set the standard at the lower level with no consideration of the enormous energy conservation cost of that decision.
- NHTSA chose to define “feasibility” and “practicability” in a manner that lets the least fuel-efficient automakers drive down the standard. It protects the least capable automakers rather than requiring them to rise up to the level that the industry as a whole could achieve. Ironically, by setting a lower standard, in the face of dramatically rising consumer expectations, the Administration is creating an environment of failure for those companies who are driving down the standard.

These obvious and clear flaws in the Administration’s analysis have lead NHTSA to propose standards that are far too low. Correcting these flaws will result in standards that are substantially higher and save the nation much more energy at a modest economic cost. At a minimum, correcting these errors would increase gasoline savings by approximately 40 percent or just over 21 billion gallons in years 2011-2015. The incremental consumer cost of those savings would be just over \$53 billion or less than \$2.50 per gallon. With gasoline currently at \$4 per gallon, these additional savings would be both a good deal for consumers and the nation.

NHTSA Has Set the Unreasonably Low Standards for an Unreasonably Long Period

Throughout its analysis, NHTSA indicates that certain assumptions were made with incomplete data and without critically important information about the auto market. Nevertheless, NHTSA for no apparent reason, set this low standard for the maximum period possible allowable under the law. NHTSA excuses the failure to obtain complete and accurate data for its assumptions on the need to promulgate a standard for model year 2011 by mid-2009 in order to give automakers proper advanced notice. While that is correct, there was no need to rush to promulgate standards for later model years, certainly not 2013 through 2015. With numerous important issues still under study, it was incredibly irresponsible for NHTSA to write rules for years that do not require an expedited process, when additional time would afford a much more informed rulemaking. Critical information missing from NHTSA’s analysis includes:

- The effectiveness of available technologies for improving fuel economy;
- The cost of technologies for improving fuel economy;
- Market shares of various models in the vehicle fleet; and
- The value of reduced emissions of greenhouse gases.

Unbelievably, NHTSA fully recognized that it did not have reliable and accurate information in these areas and would obtain that information only after the rule was promulgated!

Additional and critical information missing from the Administration's analysis resulted in NHTSA making projections that were way ahead of the data available to them. This is, however, data that could be obtained, which would provide a much firmer basis for developing a rule that applies to 2013 vehicles and beyond. Without this critical data, NHTSA's conclusions:

- Relied on old sales data and projections in a time of rapid change in the industry;
- Failed to consider the impact of vehicle mix on safety;
- Did not incorporate technology adoption strategies ("pull ahead") that speed penetration of fuel-saving technology into the vehicle fleet;
- Ignored recent changes in fuel economy and the practices of automakers in adopting fuel economy technologies; and
- Overlooked changes in vehicle usage patterns across time.

Some underlying data used by NHTSA is suspect and would benefit greatly from even a small amount of further research and disclosure by the automakers, including:

- The production plans of automakers;
- Uncertainties about market share and price data;
- The validity of the speed of adoption of technology (phase-in caps) in light of dramatic changes in auto market behavior; and
- Assumptions about the compliance strategies of auto manufacturers.

There is no question that NHTSA needed to get the rulemaking started for 2011, and perhaps 2012, so it could complete the process eighteen months before the model year: but going beyond that, in light of the incredible importance of this regulation and the woeful lack of knowledge of critical aspects of the analysis, was irresponsible. NHTSA certainly could have moved forward with this rulemaking in light of these uncertainties by providing the minimum notice necessary, thereby keeping its options open for writing fuel economy standards for later years based on better information.

By rushing ahead with imperfect knowledge, faulty assumptions and a bias against fuel savings, NHTSA's approach denies the critical benefits of reduced gasoline and oil consumption to individual consumers and the nation as a whole. Therefore, it was unreasonable for NHTSA to set standards that run so far ahead of its knowledge.

The damage of NHTSA's proposed rule goes beyond the immediate impact of lost savings. By relying on a flawed analytic framework and flawed empirical specifications, this rulemaking undermines future rulemakings in two ways. First, once this framework is set, it will be difficult to change. Inertia and judicial deference make it difficult to reverse agency decisions. Second, setting a low standard makes it far more difficult for the industry to meet higher future standards. Requiring large jumps in improvements is always more expensive than gradual improvements toward a goal, so

fixing the mistakes later is harder because the industry is further behind. Because of the enormous importance of this particular rulemaking, it is critical for NHTSA to get the fundamental framework correct from the start and to set the standard at a reasonable and achievable level.

RECOMMENDATIONS

Based on our review of the proposed rule, it is clear that NHTSA's analysis is riddled with flaws. The result is a set of proposed fuel economy standards for the period 2011-2015 that is unreasonably low, covers a period that is unreasonably long, and is inadequately documented. The Administration's proposal meets neither the spirit nor the intent of the Energy Independence and Security Act of 2007.

Due to the extraordinary urgency needed to respond to the current energy crisis, we recommend the following:

1. NHTSA should explicitly correct the conceptual flaws in its model and establish clear tests and analytic approaches to evaluate standards, independent of the level at which they are set in any given proceeding. NHTSA needs to distinguish more precisely between the "ruler" by which standards will be measured and the "rule," which prescribes the standard at a given moment in time.
2. NHTSA should set the standards for 2011-2012 at a level substantially higher than it has proposed. It should use the "optimized + 50" standard, a standard we call "50/50." This level is justified when NHTSA corrects the empirical and conceptual flaws in its analytic framework. It is consistent with the level supported by NHTSA's high fuel price sensitivity case.
3. NHTSA should rescind the standards for 2013-2015, complete the gathering of the critical information they need to make an informed recommendation, and develop recommendations based on that information.

These reasonable suggestions, which have been incorporated into detailed comments and submitted to NHTSA on its proposed fuel economy standards, will enable NHTSA to meet its statutory requirements in the short run and do the best possible job of securing America's energy future in the long run. It will also bring NHTSA into compliance with the Energy Independence and Security Act of 2007. This is an extraordinary opportunity to dramatically set our country on the right course toward much needed and long overdue improvements in fuel economy. We trust that the points we have made are compelling and that the Administration will do what is in the country's best interest and adopt our recommendations.

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