Market can fuel energy solutions

By John Heywood | May 23, 2007

IN RECENT WEEKS, gasoline prices have spiked again, this time punching through the vaunted $3-a-gallon ceiling to their highest levels ever. Americans are also increasingly concerned about their dependence on foreign oil, and the resulting greenhouse gas emissions. These problems aren't going to disappear overnight. Dealing with them will require setting long-term goals and making some tough choices.

President Bush has taken some positive steps in this direction. His "Twenty in Ten" proposal seeks to reduce America's gasoline use by 20 percent by 2017. A quarter of the savings would come from improving fuel economy in passenger vehicles by raising the Corporate Average Fuel Economy standards. The remaining savings would come from using biofuels. Several bills before Congress propose a 4 percent annual increase in CAFE requirements similar to the president's plan. Still, the "Twenty in Ten" target, given its short timetable, is unlikely to succeed without real muscle from market-based measures.

The federal government created CAFE standards after the 1973 oil crisis. But once oil prices fell in the mid-'80s, interest in using them to further improve fuel economy declined. The irony is that engine and vehicle technologies have improved steadily in the past 20 years, and vehicles have become more efficient. But without either a push from CAFE standards or a pull from soaring fuel prices, the higher efficiencies are routinely offset by the increasing size, weight, speed, and performance of many vehicles. According to EPA studies, the fuel economy of the new 2007 light-duty vehicle fleet would have been more than 20 percent higher if it had weight and performance characteristics similar to 1987 vehicles. The unsettling result is that in the last 20 years the average fuel consumption in new vehicles has not changed.

Breaking this trend now through stricter CAFE standards will not be free. Tighter standards would require manufacturers to increase spending to reduce vehicle fuel consumption. The question is whether consumers are willing to pay more for that. Even at today's gasoline prices, there is little indication that consumers are demonstrating a sustained preference for fuel economy over vehicle performance.

So it is not surprising that automakers have responded to CAFE, in part, by emphasizing pricing strategies that artificially increase sales of high-efficiency cars rather than aggressively improve the fuel economy of all vehicles sold. High profit-margin gas guzzlers are used to subsidize sales of more fuel-efficient vehicles. This leads to higher costs for society as a whole and places a disproportionate share of the economic burden on US manufacturers. Shifting the vehicle sales mix toward smaller vehicles in the short term could be detrimental to Detroit's health.

But there are ways to lower the cost and the burden of relying solely on regulation. Measures that could stimulate consumer desires for fuel economy would ease both the costs and uncertainty borne by the manufacturers. Along with tightened CAFE standards, here are two proposals that could go a long way toward solving the crisis.

First, create a "feebate" system that would impose levies on the purchase of gas guzzlers while providing rebates to buyers of gas sippers. This program would allow individuals to pay for extra power and size if they so desire it, while promoting the purchase of more fuel-efficient vehicles by others. The system could be revenue-neutral, neither requiring nor producing additional government funding.

Second, raise the federal gasoline tax by 10 cents a gallon, annually. Paying more for each gallon of gas would send an ongoing price signal to consumers each time they fill up at the pump. In addition, raising the price of fuel would effectively counter the "rebound effect" that encourages increased travel due to the reduced fuel costs offered by more efficient vehicles. Part of the resulting funds could be fed into the Highway Trust Fund to improve our roads, reduce traffic congestion, and increase safety. Some funds also could provide income tax adjustments for those most affected by the fuel tax increases.

The responsibility for how we use the gasoline in our tanks should not be borne solely by the automobile industry. There is no magical technical fix that the industry can implement to solve the burgeoning fuel problem. Reducing our greenhouse gas emissions and dependence on petroleum imports will require a set of coordinated fiscal and regulatory policies that align the interests of those who manufacture our vehicles with the demands of those who use them.

John Heywood is director of the Sloan Automotive Lab at the Massachusetts Institute of Technology. He is also leader...
of a research team on fuel consumption and greenhouse gas emissions. Anup Bandivadekar and Christopher Evans, who contributed to this column, are graduate student members of that team. ■