

# The Implied Cost of Carbon Dioxide under the Cash for Clunkers Program

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August 31, 2009

## **Abstract**

The Cash for Clunker program aims to stimulate the economy, provide relief for automobile manufacturers and reduce greenhouse gas emissions. In this research note, I present estimates of the implied cost of carbon dioxide reductions under the Cash for Clunker program. The estimates suggest that the program is an expensive way to reduce greenhouse gases. This is true under a wide range of assumptions regarding the increase in fuel economy of new vehicles purchased under the program, how long the clunkers would have been on the road if not for the program, and whether we account for reductions in criteria pollutants. Conservative estimates of the implied carbon dioxide cost exceed \$450 per ton; best case scenario parameter values suggest a cost of carbon dioxide of \$200 per ton.

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\*This paper has benefitted from conversations with Severin Borenstein and Catherine Wolfram. Financial support from the UC Energy Institute and the Institute of Transportation Studies at UC Davis is gratefully acknowledged. *Affiliations:* Department of Economics and Institute of Transportation Studies, University of California, Davis; University of California Energy Institute; and NBER, *email:* crknittel@ucdavis.edu.

# 1 Introduction

The “Cash for Clunker” (CfC) program aims to stimulate the economy, provide relief for automobile manufacturers and reduce greenhouse gas emissions. In this short note, I make back of the envelope calculations of the implied cost of carbon dioxide under the program. The results suggest that the program is an expensive way to reduce carbon; this remains true when we account for reductions in criteria pollutants. Reasonable parameter values suggest an implied carbon dioxide cost in excess of \$500 per ton; best case scenario parameter values suggest a cost of carbon dioxide of \$237 per ton.

The reason for these results is easy to understand. Imagine a CfC program with a \$4500 rebate. Suppose the driving habits of both the clunkers and new cars are same, say an annual vehicle miles travelled of 12,000 miles. If the clunker’s fuel economy is 16 mpg, while the new car’s fuel economy is 25 mpg, then the scrappage program saves 270 gallons for every year the clunker would have been on the road. When burned, a gallon of gasoline creates roughly 20 pounds of carbon dioxide.<sup>1</sup> Therefore, the program saves 2.7 tons of carbon dioxide each year the clunker would have survived. If the clunker would have survived another four years, the program has saved 10.8 tons of carbon dioxide for \$4,500, or an average cost of over \$400 per ton.

In this note I discuss and show how expanding on this simple example changes the cost estimates. For example, the car may have survived for a longer, or shorter, time period. The new vehicle might be driven more than the clunker. Or, we may want to account for reductions in other pollutants.

I do not attempt to estimate the benefits of the program on stimulus grounds. These benefits should be added to the environmental benefits discussed in this analysis to answer the question of whether the Cash for Clunkers program was a success. I leave this question for a broader analysis of the program, but note that key legislators have suggested that the environmental gains from the program are large.

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<sup>1</sup>Throughout the paper, I use greenhouse gases and carbon dioxide interchangeably, but note that automobile air conditioning systems emit other greenhouse gases.

## 2 Model Set Up

An ideal investigation of the cost effectiveness of the program would calculate the amount of carbon that would be emitted absent the program and compare it to the amount of carbon that will be emitted with it. Given that a gallon of gas creates roughly 20 pounds of CO<sub>2</sub> when burned, the amount of carbon dioxide saved by the program, in tons, is given as:

$$GHG_{savings} = \frac{1}{100} \cdot \sum_{i=1}^N \sum_{t=1}^T (gallons/mile_{itc} \cdot miles_{itc} - gallons/mile_{itn} \cdot miles_{itn}) \quad (1)$$

where  $c$  represents the clunker,  $n$  the new car and  $i$  indexes the consumers taking advantage of the program. The second summation sums the difference in annual greenhouse gas emissions over the life of the clunker.<sup>2</sup> Ideally, we would know the joint distribution of the variables in equation (1), since the the four variables are unlikely to be independent. For example, those consumers choosing more fuel efficiency may do so because they drive more.

Absent the full distribution, as well as information about future driving habits and the unobserved mileage of the clunker had CfC not existed, I use simple means of the variables in equation 1. I assume a variety of values for the increased speed with which the clunker is scrapped.

According to a recent report, the average mileage of clunkers for the entire program was 15.8 mpg; the average mileage of new cars purchased under the program was 24.9 mpg.<sup>3</sup> As a starting point, I assume that the clunker would have been driven 12,000 miles. I begin using the most conservative assumption that the new car is driven the same amount as the clunker.

There are at least three reasons to believe that the new vehicle will be driven more miles than the clunker. First, there is the classic “rebound” effect. Given the increase in fuel efficiency of the new car, the marginal cost of driving is lower. Second, numerous reports suggest that consumers are

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<sup>2</sup>This makes at three simplifications. First, there is no discounting. Second, this assumes that the consumer would have purchased a vehicle with the same fuel economy at time  $T$  that she purchased under the CfC program. Third, it ignores the greenhouse gases emitted from the manufacturing of the new car and the scrapping of the clunker. See, Allan, Carpenter and Morrison (2008) for an analysis of these emissions.

<sup>3</sup>A previous version of this study was written prior to the end of the program and used slightly different figures. [http://voices.washingtonpost.com/economy-watch/2009/08/cash-for-clunkers-winds-up\\_cos.html](http://voices.washingtonpost.com/economy-watch/2009/08/cash-for-clunkers-winds-up_cos.html)

trading vehicles that were not being used.<sup>4</sup> Third, the new vehicle is likely to be more comfortable, also reducing the marginal cost of driving.

Estimates of the rebound effect exist. Small and van Dender (2007) estimate a long run rebound elasticity of 0.11 over the period of 1997 to 2001. In section 3, I vary the rebound/adverse selection parameter.

Under these assumptions, if the clunker is taken off of the road four years earlier because of the program, then the CfC program saves 11.1 tons of carbon dioxide per sale.<sup>5</sup> Assuming an average rebate of \$4200, this implies an average cost of carbon dioxide of \$378 per ton (reported in Table 2).<sup>6</sup> If we increase the length the clunker would have been on the road to five years, the implied cost of carbon dioxide is \$303. If this is reduced to three years, the implied cost is \$504.

Another way to interpret the savings in greenhouse gases is to ask how much more fuel efficient would the new vehicles have to be for the program to be cost effective? The CBO recently projected the allowance prices under the Waxman-Markey cap and trade program would be \$28 per ton. At any reasonable scrappage rate, the cost per carbon dioxide under the CfC program exceeds this tenfold. Indeed, even if the new cars were greenhouse gas free, the clunkers would have had to have been driven 12,000 mile per year for over 20 years if not for the CfC program. This is not surprising once the simple calculations are done. At 15.8 miles per gallon, driven 12,000 miles, the clunkers consume 759.5 gallons per year, thereby emitting 7.5 tons of carbon dioxide per year. At an average CfC rebate of \$4,200, the program must save 150 tons per vehicle to have an implied carbon dioxide price of \$28. Once the greenhouse gases of the new vehicles are considered, the clunkers would have had to have been on the road for over 50 years, even with no rebound or adverse selection.

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<sup>4</sup>See, for example, <http://blogs.consumerreports.org/cars/2009/07/cash-for-clunkers-government-stalls-the-cars-program.html>

<sup>5</sup>The spreadsheet used to make all of the calculations in this note is available at: [http://www.econ.ucdavis.edu/faculty/knittel/papers/CfC\\_final.xls](http://www.econ.ucdavis.edu/faculty/knittel/papers/CfC_final.xls)

<sup>6</sup>The average rebate across the entire program was \$4,200.

## 3 Alternative Parameter Values

### 3.1 Varying the Scrapage Rate

I previously reported results assuming that the clunkers are taken off of the road either three, four, or five years earlier due to the program. The longer the clunkers would have stayed on the road, the more cost effective the policy. Figure 1 plots the implied carbon dioxide cost allowing the clunker to have stayed on the road up to tens years and setting the other parameters at their “base” levels.<sup>7</sup> Even if the program takes vehicles that would have continued to have been driven 12,000 miles per year for 10 additional years, the implied carbon dioxide price is over \$150 per ton.

What are reasonable estimates of the number of years the clunker would have been on the road? I use estimates from Lu (2006) for guidance. Lu estimates survival rates and vehicle miles travelled across vehicle vintages for both cars and light trucks. Ideally, we would have information about the distribution of clunkers under the program to calculate trade-in specific estimates of the miles the car was likely to have driven and its survival. Even this, however, would not be ideal since those vehicles traded in are likely to have been driven more miles than the average vehicle of their age.

From the survival probabilities, if we assume independence of the hazard rates across years, we can calculate the expected life of a vehicle, conditional on surviving a certain time period. If we use the average age of trade-ins under the program, between 13 and 14 years, then the expected number of years a car would have stayed on the road is 3.5 year, for trucks this is 7.5 years. This calculation suggests the reduction in the life of the average vehicle in the program is roughly five years. However, if we include information about the driving habits of these vehicles, five years is likely too long of a “credit”. The expected number of miles a 13 year old car will travel is 30,300. The expected number of miles a 13 year old truck will travel is 63,400. The average of these two is 45,000, or roughly 4 years at 12,000 miles per year.<sup>8</sup>

### 3.2 Varying Rebound/Adverse Selection Parameter

The base set of results assumes that vehicle miles travelled (VMT) of new cars purchased under the program does not increase, despite the increase in fuel economy and any adverse selection effects.

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<sup>7</sup>This does not “discount” the CO2 reductions in any way.

<sup>8</sup>I do not have information on the fraction of cars and trucks being traded in.

Figure 2 plots the implied carbon dioxide prices allowing this parameter to range from zero to 0.50, under three, four and five years of scrappage. Table 2 reports results assuming rebound elasticities of 0.1, 0.25, and 0.5. As a frame of reference, at a rebound elasticity of 0.5, implying the new car is driven 3,456 more miles than the clunker, the implied carbon dioxide costs are \$832 per ton for a four year scrappage increase.

What is the preferred estimate? Ideally, we would know the miles the clunker would have been driven and compare this to the miles the new car will be driven to calculate greenhouse gas savings. This information obviously does not exist. Again, the calculations in Lu (2006) provide some guidance. For the greenhouse gas savings what matters is the total miles driven by the new and the clunker. Again, the calculations in Lu suggest that a 13-year-old car will be driven for 3.5 years with an expected VMT of 30,300 miles. At the average mpg of clunkers, this implies 1,917 gallons of gas consumed. In the first 3.5 years of a new car, the expected VMT is 47,726. At the average mpg of new cars, this also implies a total consumption of 1,917 gallons of gasoline. These calculations imply no reductions in greenhouse gases. A similar story exists for trucks. The expected VMT of a 13-year-old truck is 63,400. At the average mpg of clunkers (which, unfortunately, is the average across cars and trucks), the clunker would consume 4,013 gallons of gasoline. A new light truck, driven for 7.5 years, has an expected VMT of 101,704, thereby consuming 4,084 gallons, suggesting an increase in greenhouse gases.<sup>9</sup>

There are many reasons to think that the increase in VMT will not be so extreme as to raise greenhouse gases from the program, but these calculations at least suggest that it is possible. For example, a family of three may trade in their teenager's car, that was being driven only 6,000 miles, and purchase a new car that will primarily be driven by one of the parents, shifting the parent's previous car to the teenager. Under this scenario aggregate VMT may not increase. However, the reductions in fuel consumption are uncertain since, while the teenager's "new" car is more fuel efficient than her previous car, the parent's new car may not be.

It is, however, unlikely that VMT will *fall* due to the program. Given this, we can continue to view the zero rebound results as representing conservative estimates of the implied carbon dioxide price of the program. But, it would seem that moderate increases in VMT are equally, if not more,

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<sup>9</sup>This accords with a recent Consumer Reports article polls participants in the program and finds that the average clunker was driven only 6,000 miles in the previous year. <http://blogs.consumerreports.org/cars/2009/07/cash-for-clunkers-government-stalls-the-cars-program.html>

likely than no increase.

### 3.3 Accounting for Co-benefits from Criteria Pollutants

Automobiles not only emit greenhouse gases, but they also emit criteria pollutants—pollution that causes more localized health and environmental damage. In particular, cars emit nitrogen oxides, hydrocarbons, particulate matter and carbon monoxide. New cars purchased under the program are not only more fuel efficient, but they are also cleaner in terms of criteria pollutants. This is due in large part to state and federal standards regulating the amount of these pollutants that can be emitted on a grams per mile basis.

To account for these reductions, I subtract the social benefits from criteria pollutant reductions from the implied carbon dioxide price. This requires assumptions regarding how much cleaner the new cars are, relative to the clunkers, and the social costs of these emissions. The average age of the clunkers is between 13 and 14 years old. As a conservative estimate of the average criteria pollutant emissions of clunkers, I use the Federal standards for NO<sub>x</sub>, VOCs, PM<sub>10</sub> and CO in 1990. For NO<sub>x</sub>, this standard began in 1988; the VOC standard began in 1984, PM<sub>10</sub> in 1987 and CO in 1984. Therefore, these are close to the best case scenarios since vehicles with models years older than 1983 do not qualify for the program. For new cars, I use the current standards.

I use the expected marginal social damages for NO<sub>x</sub>, VOCs and PM<sub>10</sub> from Muller and Mendelsohn (forthcoming). For CO, McCubbin and Delucchi (1994) report a cost per kilogram ranging from 0.01 to 0.09, in 1990 dollars. This implies a cost per ton of between \$15 and \$134 in 2009 dollars. I use the average of this range.

Cash for Clunkers remains an expensive way to reduce greenhouse gases even when we “credit” for criteria pollutants. Table 2 reports the results using the parameters from the base case. The implied cost of carbon dioxide is \$466, \$327 and \$239 for three, four and five year scrappage time, respectively. If we increase the social costs of each pollutant by 50 percent, the implied cost of carbon dioxide remains above \$200 per ton. This is the lower bound of the estimates in this note.

## 4 Additional Issues

### 4.1 Should Gasoline Savings be Included?

One frequent claim is that the gasoline savings should be included as a net gain to society. For this to be true, we must believe that consumers are making “mistakes” in their vehicle purchase decisions. That is, they would be better off if they chose another vehicle at the time of purchase, or sold their existing vehicle and purchased a more fuel efficient vehicle, but *they are unaware of this*.

A simple example illustrates this point. Suppose that a consumer in the program trades in their current vehicle that gets 16 mpg and buys a new vehicle that gets 25 mpg. If not for the program, she would have bought another vehicle that gets 16 mpg. Is the fuel savings from the 9 mpg increase a bonus to society? If so, then the cost of the program would be \$4,500 minus the fuel savings, which assuming 12,000 miles per year and a price of gasoline of \$3.00 per gallon saves \$810 per year. Even if we account for only 4 years of these fuel savings, the “credited CfC rebate” is very low.

Crediting for the gasoline savings ignores a key aspect of this decision: absent the program, the consumer *prefers* the 16 mpg vehicle. Therefore, she gets more utility, or happiness, from the 16 mpg vehicle. In fact, we can place a bound on how much more utility she gets from the lower efficient vehicle, in dollar terms. We know that she could drive the 25 mpg vehicle and save \$810 dollars per year; therefore, she gets *at least* \$810 more utility, per year, from the 16 mpg vehicle. For this reason, we should *not* credit the fuel savings when calculating the implied cost of carbon from the program. Again, unless we believe she is mistaken in her preferences. If we believe that she doesn’t actually get more utility from the less fuel efficient vehicle, then by incentivizing her to buy the more fuel efficient vehicle, we are making her better off. Under this scenario, correcting this mistake is a gain to society.

The same is true of people who have purchased their vehicles in the past and absent the program would have kept driving their existing vehicle; also note that this is independent of whether they originally purchased their current vehicle under a regime of lower gasoline prices. The fact that these consumers would choose to continue driving their current vehicles, absent the program, tells us that the utility from their existing vehicle (also accounting for the cost of this vehicle relative to a new one and the transaction costs of selling and buying a new vehicle) exceeds the fuel savings of

a more efficient vehicle. Only if we are willing to ignore this by assuming consumers systematically make mistakes should we “credit” the program for the fuel savings.<sup>10</sup>

## 4.2 Considering Future Vehicle Purchases

One effect that is worth noting is that the analysis must make assumptions about the “counterfactual” vehicles that CfC participants would have purchased if not for the program, whenever the clunker was to be replaced. The implicit assumption is that the vehicle purchased under the CfC program would have been purchased three, four or five years in the future, if not for the program. One reason this would over estimate the costs of the CfC program is if this future vehicle would have been less fuel efficient. For example, if an SUV owner would have purchased another SUV four years from now if not for the program, but decides to buy a sedan instead. The greenhouse gas gains from the program would therefore be larger since these gains exist for the entire life of the sedan. However, it may also go in the other direction. Insofar as the CfC program speeds up the decision to purchase a new vehicle, technological advances, as well as tighter fuel economy standards in near future, push future vehicles to be more fuel efficient than those purchased under CfC.<sup>11</sup>

Furthermore, we are “crediting” the CfC program with the entire clunker-to-new-vehicle increase in fuel efficiency. It is possible that a large portion of this increase would have occurred without the program, either in the present year or in the future.<sup>12</sup> This is a second type of adverse selection, in the sense that the consumers most likely to take advantage of this program are those that most likely would have purchased a more fuel efficient vehicle, if not for the program.

## 4.3 But, it is Just a Transfer

Another point that has been raised is that the money used in the program is tax payer money, therefore it is just a transfer from one group of tax payers to another. The consequence of this is that the program doesn’t actually “cost” \$4,500 per vehicle. The calculations above should not be interpreted as the social cost of the program, but instead are made to ask whether the program

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<sup>10</sup>Busse, Knittel, and Zettelmeyer (2008) find that consumers may make mistakes in the other direction, in the sense that when fuel prices increase they shift too far into fuel efficient vehicles.

<sup>11</sup>See Knittel (2009) for an analysis of technological progress in the automobile industry.

<sup>12</sup>This is the topic of current work.

efficiently pays for greenhouse gas reductions. For example, suppose the Waxman-Markey cap and trade program existed and allowance prices traded for \$28. Ignoring the obvious change in the permit price if the government bought \$3 billion worth of permits, the government could use the \$3 billion to buy permits and tear them up. These expenditures are also a transfer, but this transfer is much more cost effective, again as an environmental program.

More generally, if the government offered a subsidy for reducing an externality, we would want that subsidy to reflect the true social cost of the externality it is paying for. The actual payments of the subsidy would be a transfer, but we would still be paying too much and eliciting inefficient behavior.

## 5 Conclusions

The Cash for Clunker program is both a stimulus and environmental program. In this note, I calculate the implied cost of greenhouse gas emission reductions and find that they exceed those estimates from the Waxman-Markey bill by nearly tenfold. The program may have been a success as both an environmental and stimulus program, but this paper places bounds on how large the stimulus benefits have to be for this to be the case.

## References

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## 6 Tables

	<b>Cost of Carbon Dioxide (per ton)</b>		
	Three Years	Four Years	Five Years
Base Case	\$ 504	\$ 378	\$ 303
Rebound elasticity of 0.10 (691 mile increase)	\$ 560	\$ 420	\$ 336
Rebound elasticity of 0.25 (1,728 miles increase)	\$ 673	\$ 504	\$ 404
Rebound elasticity of 0.50 (3,456 mile increase)	\$ 1,009	\$ 757	\$ 605
Accounting for for Criteria Pollutants	\$ 466	\$ 327	\$ 239
Accounting for for Criteria Pollutants with rebound elasticity of 0.10	\$ 523	\$ 370	\$ 274
Accounting for for Criteria Pollutants with rebound elasticity of 0.25	\$ 636	\$ 456	\$ 343
Accounting for for Criteria Pollutants with rebound elasticity of 0.50	\$ 975	\$ 711	\$ 548
50% increase in Social Cost of Criteria Pollutants, no rebound	\$ 447	\$ 301	\$ 207

Table of results from Christopher R. Knittel "The Implied Cost of Carbon under the Cash for Clunkers Program" using the final MPG numbers for new cars and clunkers:

New Cars: 24.9 MPG

Clunkers: 15.8 MPG

Table 1: Cost of Carbon Dioxide Estimates

Vintage	Cars		Light Trucks	
	Survival Probability	VMT	Survival Probability	VMT
1	0.9900	14,231	0.9741	16,085
2	0.9831	13,961	0.9603	15,782
3	0.9731	13,669	0.9420	15,442
4	0.9593	13,357	0.9190	15,069
5	0.9413	13,028	0.8913	14,667
6	0.9188	12,683	0.8590	14,239
7	0.8918	12,325	0.8226	13,790
8	0.8604	11,956	0.7827	13,323
9	0.8252	11,578	0.7401	12,844
10	0.7866	11,193	0.6956	12,356
11	0.7170	10,804	0.6501	11,863
12	0.6125	10,413	0.6040	11,369
13	0.5094	10,022	0.5517	10,879
14	0.4142	9,633	0.5009	10,396
15	0.3308	9,249	0.4522	9,924
16	0.2604	8,871	0.4062	9,468
17	0.2028	8,502	0.3633	9,032
18	0.1565	8,144	0.3236	8,619
19	0.1200	7,799	0.2873	8,234
20	0.0916	7,469	0.2542	7,881
21	0.0696	7,157	0.2244	7,565
22	0.0527	6,866	0.1975	7,288
23	0.0399	6,596	0.1735	7,055
24	0.0301	6,350	0.1522	6,871
25	0.0227	6,131	0.1332	6,739
26			0.1165	6,663
27			0.1017	6,648
28			0.0887	6,648
29			0.0773	6,648
30			0.0673	6,648
31			0.0586	6,648
32			0.0509	6,648
33			0.0443	6,648
34			0.0385	6,648
35			0.0334	6,648
36			0.0290	6,648

Table 2: Survival and VMT by Vintage

## 7 Figures

Figure 1: Varying the Scrappage Rate

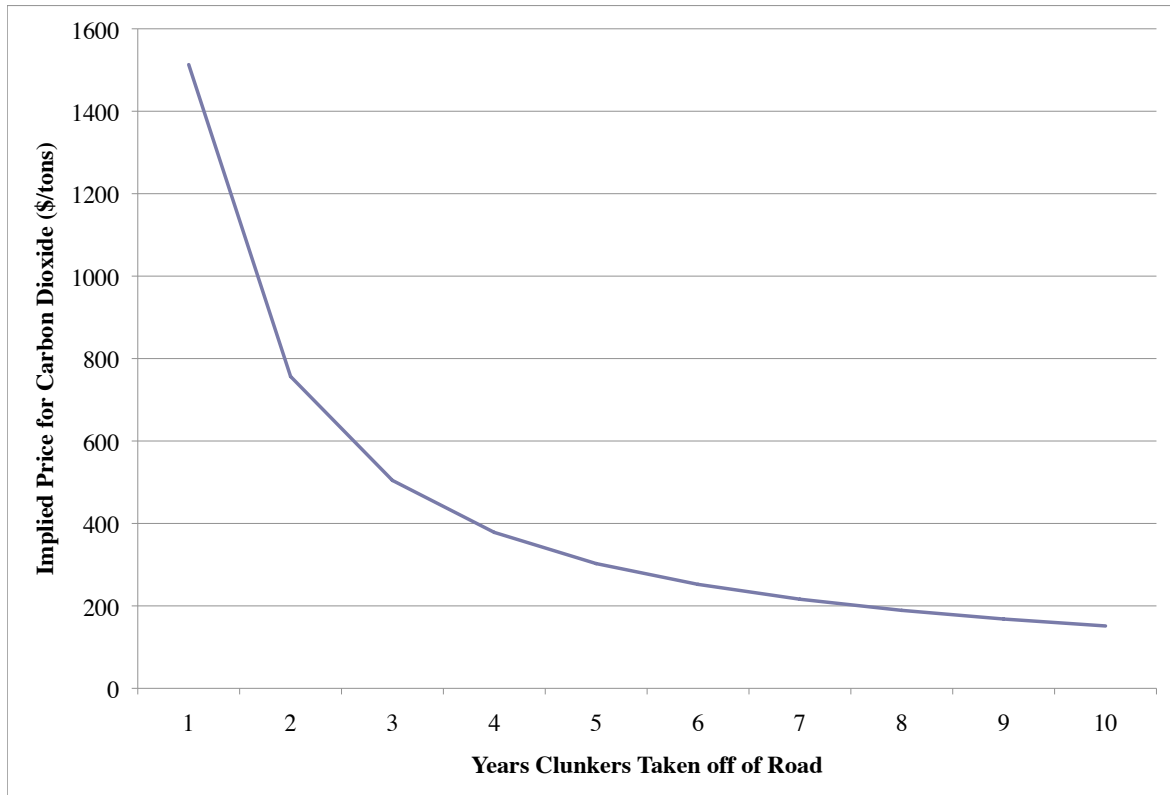


Figure 2: Varying the Rebound/Adverse Selection Elasticity

