

Fuel Economy Detroit Could Love

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For thirty years the Big Three fought CAFE standards with great success. Then the price of gas went up and the power balance shifted. The Big Three lost some ground, but with gas prices down again, there will be no end to fighting. The fault lies neither with automakers nor with environmentalists, but with a poor design.

The CAFE design hurts the Big Three's profits, and creates a standard-setting process they can often tie in knots. They are the experts on the cost of manufacturing—a crucial input to that process.

The first step towards a good design is the simplest. Eliminate the standards! It's simpler and more effective to motivate automakers with competition—that's what they're used to and it works. And what's the oldest form of competition? Of course, a race. No standards needed, just a prize. No one will argue at the hearing, "Oh, that prize is too high; we can't make cars that good."

The prizes are just payments made in proportion to how many gallons each car saves relative to the national average. Below-average cars must pay in proportion to the extra gas they use, which covers the cost of all the prizes. Gallons saved are calculated using EPA's mileage test and an arbitrary but sensible lifetime mileage for a car, perhaps 120,000 miles. If the prize is \$1.50 per gallon, then a car that saves 2000 gallons over its life earns a \$3000 prize.

We've now gained three advantages. First, there will be no more haggling over standards. Second, the race can start immediately instead of waiting five years for retooling. Even the first year, companies can build and sell more of their better cars. Third, prizes keep the pressure on every company and every car, unlike a standard, which, once met, says "good enough."

But there's always one concern that tops the list: "A prize is just too weak. We need the iron fist of standards." But consider a mileage improvement that would cost \$1,000. If the prize for making that improvement is \$2,000, the car maker will make the improvement and pocket the change. Given the way CAFE standards are actually set, according government estimates, a \$1.50 per gallon prize would more than cover the cost of any of the improvements needed to meet CAFE standards. An if more improvement is desired, just increase the prize. Again, no one can claim the bar's been set too high.

But can the Big Three win this race and claim the prizes, or will they lose and be stuck paying penalties? Suppose we wanted to motivate students with a prize to get better grades. The good students will get most of the prize money—unless ... Suppose the prize is for improvement. Now who will earn the biggest prizes? Will it be those already at the head of the class, or those with most room to improve?

But tilting toward those who are now behind, does not take any pressure off those in the lead. Every model and every automaker is under exactly the same unceasing pressure to improve. That's why real competition works so well.

It's long past time to replace bureaucratic standards with strong and simple competition. And, if we reward improvement, better fuel economy may just be something Detroit could learn to love.

* Visit <http://stoff.com/p/122.html> for more information.