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Cash for Clunkers: Just Spinning Wheels

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Is the federal government's "cash for clunkers" program a success? It has certainly been popular with car buyers, who have rushed to dealerships around the country to get their cars—and cash—under the program. In less than a week, the $1 billion put aside by Congress for the program has been depleted. To prevent the program from ending, the U.S. House of Representatives quickly approved an extra $2 billion to expand the program. The U.S. Senate will most likely take up the issue this week.

But there is a difference between popularity and success. The strong response to the program should be no surprise: No one doubts that if you hand out free cash, people will take it. But there is little evidence that the program is actually helping the economy or the environment.

How the Program Works. The cash-for-clunkers program (officially known as the "Car Allowance Rebate System," or CARS) provides $3,500–$4,500 rebates to consumers who purchase more fuel efficient cars and trade in their old vehicle. The government offers a tax credit to participating dealerships throughout the country. The tax credit will lower the sticker price for buyers, and the dealers would then receive reimbursement from the government.

The exact amount depends on the type of vehicle bought and the difference between the new vehicle's fuel efficiency and that of the trade-in, which is required to be destroyed. The program officially began July 27 but applies to vehicles purchased on or after July 1, with the end date being November 1.

Shifting, Not Creating, Demand. The program has undoubtedly led to a bump in sales. As one dealer in Florida put it, "We're selling cars like candy bars."[1] As of this Tuesday, some 157,000 cash-for-clunkers transactions have been recorded, costing some $664 million.[2] By the end of the week, the program is expected to have run through the full $1 billion allocated for it, which had been expected to last until November.

Despite its popularity, however, the program is likely doing little for the economy or for American consumers. Rather than creating new demand, the program may actually just be causing consumers to make purchases a few months earlier than they otherwise would have.

A Macroeconomic Advisers analysis last month concluded that half of the trade-ins under the program would have happened during the same period of time without the policy in place, with the other half sold in subsequent months after November 1.[3]

In addition to cannibalizing future car sales, the program may also have a negative effect on new spending elsewhere. When consumers make the commitment to purchase a new vehicle, they will likely cut spending in other areas to maintain their budget. This was the case in Germany, where retailers took a big hit when the German government implemented a similar program.[4]

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Hurting Low-Income Consumers. Nor is the program helping out families in need. In fact, a survey of car dealerships and 2,200 consumers conducted by CNW Research found that the average income of those purchasing new cars under the program was $57,700—only slightly below the $61,000 for all new car buyers.[5]

In fact, the program is more likely hurting financially struggling families. Rather than buying new cars, low-income consumers have long relied on the used car market. Yet by destroying hundreds of thousands of used vehicles, the price of such vehicles will likely increase.

Questionable Environmental Benefits. The program is also unlikely to deliver the environmental benefits that have been promised.

According to CNW Research, cars being traded in under the program so far have averaged 16.3 mpg, with new cars averaging 24.8. But this does not necessarily mean fewer carbon emissions. New cars tend to be driven more for a variety of reasons, ranging from reduced fuel and maintenance costs to the excitement of a new car. According to CNW, the cars traded in were driven some 6,000 miles per year, compared to the average for a new car of 12,000 miles.

Even if the newly acquired vehicles are driven less than that average, environmental benefits could still be erased. And once the environmental costs of building a new car and destroying the old one are taken into account, the program's environmental benefits begin to look quite doubtful.[6]

Clunker of a Bill. Despite its popularity, the cash-for-clunkers program is no success—unless success is defined as spending a lot of money quickly. The reality is that people will buy anything if the government provides a large enough subsidy.

When dealerships offer discounts and special deals, those incentives work. But it is the taxpayer funding cash for clunkers. And although the policy is giving dealerships a temporary summertime boost, most of that boost is likely coming at the expense of future sales and other goods and services. At the same time, it is doing little to help the environment while hurting low-income Americans. Rather than provide more cash for this clunker, it should be scrapped.

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