TESTIMONY OF

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Committee on Commerce, Science and Transportation

Hearing on "Pending Corporate Average Fuel Economy Legislation"

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Good afternoon, Mr. Chairman and members of the Committee. I am Michael J. Stanton, President and CEO of the Association of International Automobile Manufacturers, Inc. (ñAIAMò). I appreciate the opportunity to discuss with you today the very important matter of legislation regarding the Corporate Average Fuel Economy (CAFE) standards program.

AIAM is a trade association representing 14 international motor vehicle manufacturers who account for 40 percent of all passenger cars and light trucks sold annually in the United States. AIAM members have invested over $35.5 billion in 47 U.S. vehicle plants, component manufacturing facilities and R&D centers which employ 92,500 Americans with a payroll of nearly $7 billion. AIAM member company U.S. facilities produced 3.37 million units in 2005 ï more than 31% of total U.S. production. More than half (54%) of all vehicles sold by AIAM members in the United States are made in the United States.

AIAM members plan to invest another $3 billion in the United States to create 7,000 new American jobs by 2009 by constructing three new vehicle assembly plants and an engine plant and expanding existing facilities. AIAM companies purchased nearly $52 billion in parts and materials from U.S. suppliers in 2005 and that number is growing.

AIAM member companies have for many years been leaders in offering fuel-efficient vehicles for the U.S. market. Historically, vehicles produced by our

member companies have topped the Environmental Protection Agencyôs (EPA) annual list of most fuel-efficient vehicles. Nine of the top ten models on the EPA's Fuel Economy Leaders list for 2007 are manufactured by AIAM members. Member companies have achieved this fuel economy leadership to a significant degree by pioneering the introduction of advanced automotive technology into their vehicles. In recent years, this leadership has been demonstrated with the introduction and popular acceptance of hybrid vehicles and continuously variable transmissions and successful development work on other advanced technology vehicles including fuel cells. Starting in 1999, AIAM members were the first to offer American consumers hybrid electric vehicles and have now sold more than a half-million hybrids in the United States. For the 2007 model year, AIAM members offer eight hybrid models ï six cars and two SUVs. Our member companies continue to introduce a variety of advanced technology models.

AIAM and its members have historically taken progressive positions with regard to the related issues of fuel economy, energy security and global climate change. We have consistently supported the national need to address these matters and for the auto industry to play a constructive role in that process. In a 2001 statement before the National Academy of Sciences (NAS), AIAM recognized that the seriousness of energy security and global climate change justify a regulatory role for the Federal government in enhancing vehicle fuel efficiency. At that time we urged that consideration be given to the adoption of an attribute-based CAFE standards system, such as one based on vehicle market class, size,

or weight. AIAM supports increasing CAFE standards through rulemaking by the U.S. Department of Transportation (DOT) as a reasonable approach to enhancing national security and energy conservation and reducing greenhouse gas emissions from motor vehicles. Our support for such standards is conditioned upon the standards being technologically achievable, providing manufacturers adequate leadtime for compliance, and being established in a form that does not discriminate against any segment of the auto industry. We prefer the approach of allowing DOT to set the standards, since it assures that the standards are analytically based, reflects well-understood technology developments and statutory considerations, and provides an open process for the consideration of public comments on proposed standards. It is impossible to predict future fuel prices or the rate of technology development. This makes it impossible to accurately predict the optimum level for CAFE standards. Thus, it is essential that an expert agency, such as DOT, evaluate the pace of technology development and fuel prices and adjust the standards, up or down, as needed.

The issue of adequate leadtime for new standards is critical. The current law allows DOT to set standards with a minimum of 18 months leadtime. However, the 18-month period is sufficient only for standards that impose little or no increase in stringency. For more aggressive standards, substantial leadtime is necessary to allow for development and implementation of new technology, with the most efficient technologies generally requiring the longest leadtime. Moreover, given the need for substantial in-use vehicle fleet turnover before new

technology achieves widespread market penetration, the benefits of implementation of new technology take significantly longer to substantially affect total in-use fuel consumption. In any event, major improvements in new vehicle fuel economy cannot be achieved with the current statutory leadtime. AIAM recommends that the National Highway Traffic Safety Administration (NHTSA) set standards in three year increments and provide a minimum of three years leadtime.

We generally support NHTSA's recent restructuring of the light truck CAFE standards based on size class principles. Although this program is new and we have no practical experience with it yet, we think NHTSA promulgated a good final rule based on an extensive analysis of complex data. Consequently, we favor legislation to authorize a similar restructuring of the passenger auto standards leading to the adoption of some form of attribute-based system. Such a system is desirable since it enables DOT to set standards at levels that are feasible for manufacturers that offer different mixes of vehicles, and it is more flexible in responding to changed market conditions. In addition, future gains in fleet fuel economy will be the result of technology and not shifting fleet mix.

AIAM unequivocally opposes the adoption of a uniform percentage improvement (UPI) standards format, or any other similarly discriminatory program. Simply stated, such standards represent bad public policy. The UPI format has been roundly criticized and thoroughly discredited by several respected organizations,

including two National Academy of Sciences Committees that considered the CAFE program, the Office of Technology Assessment, and the U.S. Department of Justice. The UPI format would create unique fuel economy standards for each manufacturer, based on the manufacturerôs performance in a base year. The same percentage increase would be required for each company, but the actual standards differ due to differences in the fuel economy baselines. Under UPI standards, if two manufacturers were to produce the same mix of vehicle sizes and technology in the same year, one manufacturer could be assessed civil penalties while the other could be awarded credits, due to differences in the two companiesôbaselines. We believe that a system that assigns differing compliance consequences to the same conduct by two entities is fundamentally discriminatory.

Moreover, a UPI regulatory system would penalize those manufacturers that have exceeded CAFE standards, thereby discouraging any fuel economy accomplishments above the baseline in the future. The approach is also unfair because the currently available technology for improving fuel economy might already have been incorporated in the base year by the manufacturer that faces the most stringent future-year fuel economy requirements, leaving fewer technological options to increase fuel economy in the future. In addition, the selection of the base year could create arbitrary advantages or disadvantages for the manufacturers due to the product mix or technology that was applied by the

manufacturers in that year. Under a UPI system, manufacturers with high average fuel economies would be impeded in entering U.S. markets for larger vehicles because such entry ï even if they produce more efficient larger vehicles than are currently available ï could prevent them from meeting the new standards. Thus, competition would suffer and the fuel efficiency of a whole category of vehicles could be kept artificially low.

AIAM supports the elimination of the domestic/import separate fleet requirement for passenger autos. The current law requires dividing a manufacturerôs passenger automobile fleet into domestic and import classes that must comply separately with fuel economy standards. There is no similar requirement for light trucks. This requirement was originally intended to inhibit domestic manufacturers from simply importing large numbers of small, ñcaptive importò vehicles as a compliance strategy. This provision has created a disincentive for foreign-based companies to increase the U.S. content of their vehicles to levels above 75 percent, since doing so would place the vehicles in a separate compliance fleet. This disincentive is real, not theoretical, and has cost U.S. jobs. This domestic/import separate fleet requirement has also had the perverse effect of content manipulation to move a model from a manufacturerôs domestic fleet to its import fleet. Attribute-based standards remove any incentive for U.S.-based manufacturers to achieve compliance by simply importing large numbers of very small vehicles.

We also support enhanced trading of CAFE credits between a manufacturerôs fleets. The law should allow credits to be traded between import and domestic passenger car fleets and between passenger autos and light trucks. We envision this expanded credit trading authority as being conceptually consistent with the current authority for year-to-year transfer of credits. In the current system, credits are calculated as the product of a number of tenths of a mpg by which the standard for a class of vehicles is exceeded multiplied by the number of vehicles in the credit earning class, with the total credit amount thus calculated being available to offset a CAFE shortfall. This approach would maintain the fleet average concept that is central to the determination of compliance under the existing law. The carry-forward and carry-back provisions in current law should also in our view be extended from three years to five years. This will have no adverse effect on fuel savings but will provide additional compliance flexibility. Enhanced credit trading has been recommended by the NAS as a means of increasing manufacturersôcompliance flexibility while reducing costs.

AIAM is concerned that state fuel economy standards or standards that are functionally equivalent to fuel economy standards would impose severe manufacturing and marketing burdens on manufacturers due to multiple inconsistent design or distribution targets. As a result of the Supreme Courtôs decision in *Massachusetts v. EPA,* NHTSA has authority to set fuel economy standards and EPA has authority to set emission standards. We believe that the methods for complying with CAFE standards and with carbon dioxide emissions

standards are so similar as to be virtually indistinguishable. AIAM favors a national program that avoids separate state requirements. Congress should address this issue as it moves forward.

The effectiveness of CAFE would be significantly enhanced if coupled with appropriate, market-based incentives for consumers. Tax credits for advanced technology vehicles are an example of an incentive that is potentially very effective. Such credits are helpful in overcoming the effect of high initial costs of new technology, assisting in stimulating sufficient demand for the new technology to allow production volumes to increase to levels where costs begin to decrease.

The energy security and climate change issues are real. AIAM and its members look forward to working with the Committee as it moves forward on this important subject.