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With $1.68-a-Gallon Gas, America's Big MPG Goals Are in Trouble

John Lippert and Jeff PlungisJan 12, 2016 10:59 am ET

(Bloomberg) -- In private meetings late last year, U.S. regulators and automakers staked out preliminary -- and opposing -- positions in a debate about the companies' ability to boost fuel economy 50 percent to 54.5 miles per gallon by 2025.

The manufacturers' message was simple: Improvements to gasoline engines, including direct-injection and turbocharging, clearly won't be enough to reach the target in nine years. It will require more gas-electric hybrids, and therefore, cost more than originally estimated. Consumers, meanwhile, haven't embraced hybrids and other green technologies nearly as fast as the government predicted.

The outcome will provide a road map for research and engineering by top automakers, who spent, according to Fiat Chrysler Automobiles NV, about $100 billion on product development in 2014. It also will determine U.S. strategy for trimming 25 percent of carbon-dioxide emissions from transportation.

"Over the weekend I saw the lowest gas prices I've seen in a long time, at $1.68 -- that's a world of hurt for selling electric and selling efficiency," said Mark Wakefield, managing director and head of the Americas automotive group at consultant AlixPartners. "Now you have consumers at odds with regulators, and, stuck in the middle, is the auto industry."

Popular Pickups

This debate is unfolding in advance of next year's so- called midterm review of the federal fuel-economy and emissions goals, along with California's zero-emission-vehicle, or ZEV, requirement, for 2022-2025. The fact that Volkswagen AG decided to cheat on emissions reporting is just one measure of the stakes. Complicating the debate: The average fuel economy of vehicles sold in 2015 fell 0.1 mpg from 2014, according to a study by the University of Michigan Transportation Research Institute, which said the decline "likely reflects the continuing drop in the price of gasoline in December and the consequent increased sales of pickup trucks, SUVs, and crossovers."

President Barack Obama agreed to the review as a concession to automakers when the targets were negotiated. The first formal step will be a technology assessment the Environmental Protection Agency, National Highway Transportation Safety Administration and California Air Resources Board will publish in June.

Expanded Credits

Privately, auto executives say they don't expect the government to gut the targets unless Republicans retake the White House. They're hoping to expand credits for green technology and roll back compliance deadlines. People familiar with the private meetings described the discussions but asked not to be named.

A handy way to frame the debate is to revisit a 2012 U.S. government press release: To achieve the goal, it said, consumers would have to pay $1,800 for fuel-saving technologies such as eight-speed transmissions but would save as much as $5,700 on gasoline during their vehicle's lifetime.

Robert Bienenfeld, U.S. senior manager of environmental strategy at Honda Motor Co., said cutting CO2 will cost significantly more than $1,800, largely because California is simultaneously requiring more ZEV vehicles, powered by batteries or fuel cells.

The $5,700 projection assumed gas would cost $3.87 a gallon in 2025 -- a dollar more than the Energy Information Administration now predicts. The government insists that while consumers will save less on gas, they'll pay a smaller amount than planned for fuel-saving technology.

Better Than Expected

Last month, the EPA said fuel economy improved 5 mpg or 26 percent in the last 10 years, more than expected, and cars and trucks averaged 274 grams per mile of greenhouse-gas emissions in 2014, or 13 fewer than allowed.

"It's clear our standards are working," Christopher Grundler, EPA director of air quality and transportation, said in a statement.

There's also a finite amount of fossil fuel, and gasoline prices are cyclical, so constant investment in efficient technologies is important, according to Jay Williams, Department of Commerce assistant secretary for economic development.

"Those fuel prices are going to creep back up," he said in an interview Monday at the North American International Auto Show in Detroit. "If we wait until that happens, we've wasted all of those years of technological advances and we'll find ourselves behind the curve."

Environmentalists' Complaints

Environmentalists complain about EPA credits that give automakers flexibility in complying with standards. The agency offers so many credits, companies will be able to fulfill their requirements with a fleet average of about 44 mpg instead of 54.5, Gopal Duleep, president of H-D Systems, an automotive research firm in Washington, said last month.

That's a problem, said Dave Cooke, a Union of Concerned Scientists analyst in Washington.

“Credits aren’t supposed to be a long-term strategy for compliance,” he said. “They’re not a substitute for investing in technology.”

Sergio Marchionne, chief executive officer of Fiat Chrysler, told reporters Monday at the auto show that the U.S. government’s requirements aren’t satisfactory. He said it’s more cost efficient, for now, to buy credits from other manufacturers or earn credits through modifications such as more efficient air-conditioning systems. That buys time to ensure future vehicles meet the standards, he added.

Consumer Demand

Even with the credits, Bob Carter, head of Toyota Motor Corp.’s U.S. operations, worries about building the fuel- efficient vehicles regulators want and then being unable to sell them.

“With $1.60 a gallon gas, consumer demand is clearly on full-size trucks that are 25 feet long,” Carter said.

Gas prices alone don’t explain why automakers are selling more trucks than fuel-efficient cars, according to Dan Becker, director of Washington watchdog group Safe Climate Campaign. Most of the industry’s $14 billion in annual marketing costs are used to promote trucks, which shouldn’t need the boost if cheaper fuel alone is driving the shift, he said.

‘Crocodile Tears’

“They don’t make very many of them, they don’t advertise them and they don’t market them,” Becker said of the high- technology fuel-saving models that could help companies meet the regulations. “The industry is crying crocodile tears on gas prices, but they’re using it as an excuse not to make the vehicles they didn’t want to make in the first place.”

Joshua Cunningham, head of sustainable-transportation technology at the California Air Resources Board, said the state can’t meet its goal of cutting CO_2 by 80 percent in 2050 from 1990 without battery-only cars. That’s true partly because its vehicle population will grow 65 percent to 38 million by mid- century. By 2040, Cunningham said, ZEVs will make up 100 percent of all new-vehicle sales.

Honda’s Bienenfeld said automakers can eliminate a ton of CO_2 for $69 with modern gasoline engines. With battery-powered cars, each additional ton removed costs $1,035. He wants California to create more incentives for plug-in hybrids, saying they’re easier for consumers to accept and eliminate each additional ton of CO_2 for $751.

“The auto companies will always be saying regulations are too difficult and costly,” Cunningham said. “We’re pretty convinced they can comply.”

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