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How Senate Moves to End CAFE Penalties Threaten Tesla’s Billion-Dollar Credit Engine and Reshape Global EV Policy

By William Harrison
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In 2024, Tesla generated $2.76 billion in regulatory credit revenue, a sum that not only eclipsed the net income of most automakers but, in certain quarters, surpassed Tesla’s own profit. The firm’s Q1 2025 net income of $420 million would have

fallen into the red otherwise, highlighting the central role that these credits play in Tesla's balance sheet. However, one Senate committee proposal risks upsetting this profitable equation and, as a result, the economics of the overall U.S. EV industry.

The proposal, proposed by Senate Republicans as part of the Trump administration's budgetary broad bill, would scrap penalties for manufacturers that do not comply with Corporate Average Fuel Economy (CAFE) requirements. The impact, as outlined by Chris Harto, Consumer Reports' senior policy analyst, is dramatic: "It also would essentially turn the CAFE standards into nothing more than a reporting requirement with no consequences for automakers who fail to improve the efficiency of the vehicles they sell." That is, the regulatory credits Tesla and others have been counting on would, overnight, effectively be rendered valueless.

CAFE standards, initially passed in 1975, were intended to encourage automakers to improve fuel efficiency by charging fines for non-compliance. The subsequent credit system enabled companies that exceeded the standards such as Tesla, which offers an all-electric lineup to sell credits in excess to those that fall short. For traditional automakers, such credits have been a lifeline, enabling them to draw out costly EV transitions while staying compliant. For Tesla, they've been a near-untainted profit stream, with little marginal cost.

The technical but important mechanics of CAFE credit calculation involve measuring each automaker's fuel economy for its entire fleet, with credits earned or penalties imposed based on how well it does against the regulatory standard. Credits may be banked, sold, or traded, and the value varies depending on supply and demand. In America, Tesla's credits have been particularly lucrative because the firm only makes zero-emission cars, which create an excess that others Ford, Stellantis, GM need to buy to stay out of trouble. As Axios adds, "This Senate action would effectively end the market for CAFE credits."

The potential reach goes beyond Tesla's bottom line. JPMorgan analysts figure that the Senate actions, along with the potential dismantling of federal EV tax credits (up to $7,500 per vehicle), could strip as much as $3.2 billion from Tesla's yearly revenue. The ripples have effects: manufacturers that have counted on credit

purchases would pull back on their EV investments, and the overall rate of U.S. emissions reduction may stall.

The wider context is an international mosaic of emissions controls and credit trading programs. Inside the European Union, for instance, car makers have tight fleet-average CO_2 targets, with fines of €95 per above-target gram of CO_2 per kilometer. Manufacturers can meet the standards by pooling credits, as when Tesla, Ford, and Stellantis collaborated to stave off hefty fines after Tesla's European sales plummeted 49% in April. According to the International Council on Clean Transportation, "If things go bad for Tesla and they don't sell enough cars this year, they might not have enough credits for what they promised Stellantis and the others." Tesla is in a tight spot.

The technological foundations of zero-emission vehicle (ZEV) technology come into play when it comes to credit assignment. ZEV credits are given out depending on a vehicle's certified emissions, battery capacity, and range. Tesla's cars, with as low as 13.1 kWh of energy per 100 km for the Model 3, consistently earn maximum credits. Tesla's energy storage business Powerwall and Megapack installations reached 11.0 GWh in 2024 also enhances its eco-friendly image, eliminating over 5.5 billion kg of CO_2 emissions and substituting 2.4 billion liters of gasoline via its Supercharger system.

Regulatory environments around the world are changing. The EU's "Fit for 55" package calls for zero fleet emissions in 2035, as does the U.K. for net zero in 2050. China also has a credit system, and Tesla has sold credits to local and joint-venture automakers there. Australia's new car efficiency regulation, which begins in January 2025, imposes 100 Australian dollars fines per gram of additional CO_2, and this has ignited a new war for credit market share between Tesla, BYD, and Polestar as Australia strengthens its rules on emissions.

The financial and technical math of car manufacturers is changing. As Stellantis's Carbon Net Zero Worldwide Purchasing Manager Emmanuel Houery described, "Each part in an EV contributes to carbon emissions." Batteries, steel, and aluminum alone equal roughly 70% of an EV's carbon footprint. Tailpipe

emissions, hence, are not the issue but the entire production process a problem that amplifies as regulations get more stringent.

Tesla's carbon credit dominance, previously regarded as invincible, now meets headwinds from regulatory shift and mounting competition. In the fourth quarter of 2023, BYD became the leading BEV manufacturer globally, marking a new era where credit revenues could be less predictable and more fiercely competed for.

To investors and analysts in the auto industry, the Senate action to phase out CAFE penalties represents more than a policy adjustment. It is a basic change in the incentive mechanism that has driven the U.S. EV transition. As Chris Harto noted at Axios, "If the administration gets its way on all of its stated policy objectives around vehicle regulations, there will no longer be any market in the US for Tesla's regulatory credits." The next few months will tell if Tesla's billion-dollar credit machine can evolve or if the policy gears will grind it into oblivion.

https://www.msn.com/en-us/money/other/how-senate-moves-to-end-cafe-penalties-threaten-tesla-s-billion-dollar-credit-engine-and-reshape-global-ev-policy/ar-AA1GvjrT