

Allocating the \$25 Billion in Direct Loan Authority to Loan Applicants

Background

Congress enacted the Energy Independence and Security Act of 2007 in part to reduce the nation's consumption of foreign oil. To achieve that purpose, Congress included in the Act an Advanced Technology Vehicle Manufacturing Incentive Program. That program authorizes the Department of Energy (DOE) to provide direct loans to auto manufacturers and their suppliers to accelerate the production of fuel efficient vehicles. These direct loans are essential to provide the capital for one of the most massive transformations of the auto industry ever.

The total amount of direct loan funds that will be requested by all applicants may well substantially exceed the \$25 billion in authorized and appropriated direct loan authority available to the DOE. Therefore, a method of allocating available direct loan authority is essential to insure that the applications offering the most effective opportunities to reduce U.S. oil consumption receive the most loan funds. This paper sets forth a proposed allocation method.

Proposed Allocation Method

Automobile manufacturers will actually produce the advanced technology vehicles that will provide the fuel savings sought by the Act. As a result, the preponderance of available direct loan funds should be expected to go to the auto manufacturers.

Under the proposed approach, DOE would evaluate applications from auto manufacturers and component manufacturers separately. For auto manufacturers, DOE would evaluate applications on the projected fuel savings that the products in the application they are expected to provide -- measured on a vehicle lifetime basis. Applicants that can show in excess of one billion gallons of fuel saved in their respective applications would be given first priority for consideration. DOE also would give priority to applications involving plants located in the U.S. that are 20 years old or older. DOE would use these two criteria in tandem to make direct loan allocation decisions.

For component manufacturers, DOE should assume that component suppliers are not able to show estimated fuel savings. Fuel savings come from vehicles not specific components. Instead, DOE should set aside 10% of available direct loan funds -- \$2.5 billion -- to allocate to component suppliers. These funds can be allocated based on the significance of the component to the advanced technology vehicle in which the component will be installed.

Allocating funds on the basis of fuel savings, rather than on the basis of fuel economy or percentage of fuel economy improvement, is good policy for two reasons. First, focusing initially on vehicles with very high fuel economy, or greatly increased fuel economy is not likely to result the greatest reductions in fuel consumption. Extremely high fuel

economy vehicles tend to be smaller volume, niche vehicles, which will not significantly lower U.S. oil usage. The greatest reductions in fuel consumption occur when lower fuel economy vehicles are improved. For instance, a 25 percent improvement of a 32 mpg vehicle—to 40 mpg—will save 750 gallons over that vehicle's lifetime. But the same 25 percent improvement of a 20 mpg vehicle—to 25 mpg—will save 1200 gallons over that vehicle's lifetime, or more than 50 percent more fuel.

Second, all vehicles must provide a substantial fuel economy improvement to be eligible for the program in the first place, so it is not necessary to, in effect, double-weight that factor. Third, and most importantly, a fuel savings parameter ensures that the direct loan funds will be used to build vehicles that are high volume, mainstream products that will have the greatest impact on the average fuel economy of the entire U.S. fleet.

Under the proposed allocation method, direct loan levels would be determined by DOE for each consolidated loan application. To the extent that multiple applicants qualify for first priority, DOE should allocate available funds so as to make direct loans to all first priority applicants in an equitable manner. Applicants will be required to modify their applications to conform them to the funds available.

Advantages

The advantages of the proposed approach include:

- The method has a sound basis;
- Approved direct loans will go those applicants who can demonstrate the most fuel savings;
- The proposed method is straight forward, transparent and relatively easy to apply;
- Component suppliers will also receive direct loan funds even though they are not likely to be able to show substantial fuel savings; and
- The method avoids the need for DOE to pick winners by selecting individual products, which could adversely impact applicants' CAFE compliance strategies.