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Stop and Start Consumption: the Cash for Clunkers Fiscal Stimulus

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An important debate in macroeconomics is the degree to which fiscal interventions can affect economic activity. Proponents of fiscal stimulus argue that targeted subsidies can spur consumers to purchase goods that they would otherwise not have purchased in the near future. Shifting purchases from well into the future to today can help jumpstart the economy.

Opponents contend that consumers quickly “undo” the effect of such short-term subsidies. While subsidies may induce purchases today, the effect is almost completely reversed when consumers subsequently purchase fewer goods tomorrow.

There are reasonable theoretical arguments on both sides of the debate; as a result, the speed with which short-term subsidies are reversed is primarily an empirical question. We inform this debate by examining the 2009 Cars Allowance Rebate System program, commonly known as “cash for clunkers.” The program, which was implemented from July 24th to August 24th, 2009, provided rebates of \$3500 to \$4500 for every low fuel efficiency used car that was traded in to purchase a higher fuel efficiency new car.

We examine this question by examining variation across U.S. cities in the number of clunkers on the road before the cash for clunkers program was implemented. The basic idea is to compare the pattern of auto purchases in cities with a high and low number of clunkers to get a sense of what would have happened in the absence of the program. The extremely rich data on every metropolitan and micropolitan area provides a far more comprehensive picture of the effect of the program relative to studies that use only aggregate auto purchases.

Using this methodology, we find a large initial impact of cash for clunkers on auto purchases, but the effect is almost completely reversed within seven months. In other words, the program induced the purchase of new autos that would otherwise have been purchased between September 2009 and March 2010.

Our estimates of the speed at which consumers undo the effect of the program are in contrast to research from the Obama Administration. For example, the Council of Economic Advisors and National Highway Traffic Safety Administration argued that cash for clunkers pulled auto purchases forward from between 3 to 7 years after the program. Our estimates suggest that consumers reversed the effect of cash for clunkers in only 7 to 10 *months*.

There is an argument to be made that bringing forward auto purchases by even a few months may be useful during a recession. However, we find no evidence that cities with a large number of clunkers experienced disproportionate rebounds in economic activity in the year after the program. We find suggestive evidence that employment in the auto sector increased after the cash for clunkers program. But this effect is hard to attribute to cash for clunkers alone given the federal bailout of General Motors and Chrysler in the spring of 2009.

The most important take-away from our research is that short-term subsidies for durable goods only pull purchases forward from the very near future. However, our results do not imply that every form of fiscal stimulus suffers from this pattern. For example, unemployment benefits may lead to a less temporary effect on purchases. Research by other scholars on the economic stimulus payments of 2008 finds no evidence that consumers purchased fewer goods in the three to six months after disbursement. But policy-makers must understand that programs designed to induce the purchase of durable goods—housing, washing machines, or automobiles—will likely steal those purchases from the near future.

The study can be found here:

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1670759