Insight

Putting the Volkswagen Settlement into Context

SAM BATKINS | JULY 12, 2016

Recently, the Environmental Protection Agency (EPA) fined automobile manufacturer Volkswagen (VW) for cheating on their emissions tests and making false representations to customers. VW had engineered their products to determine when testing was taking place and then reduce emissions, below what would have occurred during normal driving operations, also known as a "defeat device."

EPA leveled an unprecedented fine: $10 billion to directly compensate consumers under the program, in the form of approximately 500,000 vehicle buybacks; these include model years 2009 to 2015 diesel vehicles. If less than 85 percent of cars are successfully recalled, then VW must pay additional sums into a separate mitigation fund. In addition to the direct compensation, VW must spend $4.7 billion to mitigate the pollution from previously sold vehicles; $2.7 billion toward projects across the country to reduce harmful Nitrogen Oxide (NO_x) emissions, a precursor to smog, and $2 billion toward improving green infrastructure ($1.2 billion to a national plan and $800 million to California alone), for a total of $14.7 billion.

To put this $14.7 billion in context, if this settlement were a regulation, it would be the second most expensive in recent history (dating back to 2006). If all of the $14.7 billion were paid out in a year, it would be the most expensive rule since at least 2006. However, the settlement estimates VW will have three years to pay the $2.7 billion toward programs to reduce NO_x and ten years to fund the additional $2 billion toward improving green infrastructure.

For comparison, assuming VW spends $11 billion in one year, here are the most expensive regulations since 2006 (based on annual figures):

- VW Settlement: $11 billion
- 2017-2025 CAFE and GHG Standards: $10.8 billion
- Emissions Standards for Coal (MATS): $9.6 billion
- 2012-2016 CAFE and GHG Standards: $4.9 billion
- Boiler MACT: $1.6 billion

There are of course other ways to put the settlement into context. VW's market cap is "only" $58 billion, making the fine 25 percent of the company's worth. Even taking Apple's gargantuan $522 billion market cap, the fine is still 2.8 percent of Apple's value.

No one is saying VW should not have been penalized for willfully breaking the law. Fines and other punitive measure should be in place to deter reckless and intentional misconduct. However, fines should be punitive, not exacted for the purpose of implementing federal energy policy. Directing $2 billion toward green infrastructure, beyond the clean air improvements, is essentially taking from VW what EPA and other regulators could not get from Congress and American taxpayers. This moves beyond the punitive and corrective nature of fines and into EPA's preferred national energy policy.

In sum, the VW fine is historic in its scope, $14.7 billion, and in its reach. If it were a regulation, it would be one of the most expensive of all time. There are certainly many in Congress who would want to direct $2 billion toward zero emissions vehicles. What they cannot achieve through majority votes in Congress, EPA has extracted from VW as a result of the company's maleficence. The amount of the fine might well be justified, even though it's 25 percent of the company's market cap. Directing $2 billion of it to pet projects is dubious and raises notable legal concerns.