



## All about the “Two-Fleet Rule”

### **Background: Current Law**

The “two-fleet rule,” established with the first corporate average fuel economy (CAFE) standards in 1975, divides each manufacturer’s car fleet into two separate compliance classes – domestic and foreign – based on where a majority of a vehicle’s parts are made. Each class must separately meet the 27.5 mile per gallon (mpg) passenger vehicle standard. The two-fleet rule for light trucks was eliminated beginning in model year 1996.

Originally, the rule was meant to protect U.S. auto jobs by preventing manufacturers from importing large numbers of foreign-made smaller cars – primarily designed for foreign markets with tougher fuel economy requirements – in order to meet CAFE standards. At the time, foreign automakers did not object, as none had domestic production facilities. In recent decades, however, more foreign automakers have opened production in the United States.

### **Domestic v. Foreign**

Vehicles that have 75% or more of their components manufactured in the United States are considered domestic by law. Conversely, foreign cars (i.e., imports) are defined as having 26% or more parts made outside the United States. General Motors, Ford, Chrysler, Honda, Nissan, and Toyota all have production facilities in Mexico, and each of those companies except Nissan builds vehicles in Canada as well. Under NAFTA all vehicles produced in Mexico or Canada are considered “domestically produced.” This change in the determination of “domestic production” has prompted the National Academy of Sciences to conclude, “The two-fleet rule no longer serves to protect U.S. employment.”<sup>1</sup>

Most foreign automakers today claim that they are disadvantaged by the two-fleet rule, having to continue importing foreign parts to U.S. production facilities in order to keep their “import” fleets above their fuel economy benchmarks. The Association of International Automobile Manufacturers has said, “The ‘two-fleet’ provision has created the unintended consequence of providing a disincentive for foreign-based companies to increase the U.S. content of their vehicles...since doing so would place the vehicles in a separate compliance fleet. This disincentive...has cost U.S. jobs.”<sup>2</sup>

Today, Nissan is exempt from the rule. In 2005, it successfully argued that since the rule would reclassify one of its more efficient vehicles made in Mexico as domestic, its foreign fleet mileage would suffer and its domestic fleet mileage would greatly surpass the standard, causing the company to offshore some production to balance out compliance. Nissan claimed this shift would hurt their U.S. employment. The Nissan exemption expires in 2010.

The United Auto Workers (UAW) and domestic automakers, on the other hand, claim that dropping the two-fleet rule would cost U.S. jobs. They argue that the rule ensures that full-line auto manufacturers must maintain small car production in North America to balance out production of larger, less efficient

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<sup>1</sup> “Effectiveness and Impact of Corporate Average Fuel Economy (CAFE) Standards,” National Academy of Sciences report to Congress, 2002.

<sup>2</sup> See [www.aiam.org/pdfs/may3cafe.pdf](http://www.aiam.org/pdfs/may3cafe.pdf).

vehicles. However, an attribute-based system – where vehicles meet different standards based on size – would eliminate an automaker’s pressure to balance out large and small vehicle production.

A continuing and growing threat to UAW employment is the sinking market share of the Detroit Three. For the first time, Detroit’s portion of the U.S. auto market has dipped below 50%.<sup>3</sup> Part of this decline is tied to Detroit’s reliance on inefficient vehicles; Ford, GM, and Chrysler light truck sales fell 10 percent between 2004 and 2006 as gas prices rose from \$1.87 to \$2.57 per gallon. Chrysler recently announced a plan to begin importing the Chery compact car from China in order to meet rising consumer demand for higher mileage.<sup>4</sup>

### **The Senate Energy Bill**

On June 21, 2007, the U.S. Senate passed a comprehensive energy bill by a vote of 65-27. The bill, H.R. 6, contains a provision that would significantly improve automotive fuel economy standards for the first time in thirty years. The product of a careful bipartisan compromise, the provision calls for an increase to 35 mile per gallon by 2020 – averaged across the entire fleet manufactured or sold in the United States – while providing flexibility for automakers to cost-effectively meet the standard without jeopardizing U.S. jobs. The Senate bill eliminates the two-fleet distinction by treating foreign and so-called “domestically-made” cars the same in an attributed-based system where cars and trucks meet various requirements based on their size classes.

### **“Anti-Backsliding”**

Some have advocated an “anti-backsliding” provision which would create an alternative minimum standard for domestic vehicles (including those cars and trucks made in Mexico and Canada). Typically, under such a proposal, a manufacturer’s U.S.-made cars only have to meet 92% of the average fuel economy of all manufacturers’ combined domestic and foreign fleets. This is intended to provide an advantage to U.S. production.

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<sup>3</sup> Associated Press, “U.S. market share drops below 50%,” August 1, 2007. See <http://www6.autonet.ca/News/story.cfm?story=/News/2007/08/01/4385488-ap.html>.

<sup>4</sup> Forbes.com, “Ready to Buy a Chinese Car?” September, 3, 2007. See <http://members.forbes.com/forbes/2007/0903/044.html?token=MTEgU2VwIDIwMDcgMTg6MTE6MDAgKzAwMDA%253D>