

Regulatory Mandates and Electric Vehicle Product Variety*

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December 15, 2021

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Abstract

When should policies to encourage new types of products use supply-side tools, like regulations and mandates, and when should they use demand-side tools like consumer incentives? When prices are set nationally but policy varies by state, supply-side and demand-side tools are no longer equivalent. We study an important state-level supply-side policy in the early electric vehicle industry: the zero-emission vehicle mandate in California and nine other states. Focusing on the 2009–17 period, we examine two channels for policy effects: imperfect competition and endogenous product entry. Using a structural model of new vehicle pricing, demand, and product entry, we compare the mandate to a counterfactual demand-side policy that instead uses a consumer subsidy and tax. Holding fixed the regulator’s stated target, electric vehicle sales in regulated states, the demand-side policy creates a weaker incentive for socially beneficial product entry and generates lower consumer and total surplus. When fewer products are introduced, producers avoid entry costs, but forego long-run benefits of entry.

*We are grateful to our advisors (Pinter: Ariel Pakes, Robin Lee, and Dennis Yao; Armitage: Joseph Aldy, Edward Glaeser, Robin Lee, and James Stock) for their support and guidance. We also thank Jeff Gortmaker, Myrto Kalouptsidi, Stephanie Kestelman, Jing Li, Erica Moszkowski, Charles Murry, Mathias Reynaert, Gregor Schubert, Elie Tamer, Tom Wollmann, Ron Yang, Anthony Yu, and David Zhang; participants at the Harvard Industrial Organization and Environmental Economics workshops and 2019 Harvard Environmental Economics Program conference; and three industry experts. Armitage gratefully acknowledges financial support from the NBER Pre-Doctoral Fellowship in Energy Economics and the Joseph Crump Fellowship at Harvard University. Portions of this work are subject to the following: “Includes content supplied by IHS Markit; Copyright © IHS Markit, 2019. All rights reserved”.

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1 Introduction

Policymakers seeking to intervene in product markets face a choice of which tools to use: supply-side tools, which use regulations and mandates to alter the incentives to produce goods, and demand-side tools, which use subsidies and taxes to alter consumer incentives to purchase goods. Policymakers seeking to encourage new types of products, particularly alternative fuel vehicles, have adopted both types of tools, sometimes at the same time.

Standard theory predicts that supply-side and demand-side tools are typically equivalent if the policy covers the entire market. In the United States, however, environmental policy is increasingly made at the state level, while product markets are nationally integrated.¹ In an industry in which firms set national prices, state-level demand-side tools generate price variation across regions, while state-level supply-side tools do not. As a result, the two tools generate different firm incentives, producing different markups over marginal cost and different incentives for product entry. The effects on consumer, producer, and total welfare will then differ.

We study the electric vehicle industry between 2009 and 2017, and a prominent state-level supply-side policy that shaped it: the zero-emission vehicle (ZEV) mandate adopted by California and nine other states. The mandate required the largest automakers to meet a quota of electric vehicles of 0.4–1.5% of their statewide sales. To obtain credit toward the quota, the automaker could sell electric vehicles in the state or buy credits from other automakers. The goal of the mandate was to induce sales of electric vehicles to reach mass-market quantities, and particularly to encourage the entry of electric vehicles. During this period, 18 electric vehicle models were introduced in the US, and policymakers and some industry observers credited the ZEV mandate for much of this entry. Against this policy background, we investigate the

¹See, e.g., “Can America’s Blue States Tackle Climate Change on Their Own?” (Jonathan Eyer and Matthew E. Kahn, Harvard Business Review, 6/6/17).

consequences of policymakers’ choice to use a mandate rather than rely on demand-side policies, focusing on the channels of pricing (under imperfect competition) and product entry.

Our study of product entry builds on the established theoretical result that imperfectly competitive product markets can feature more or fewer products than the social optimum, because each firm does not capture the negative effect its product will have on other firms’ profits (“business stealing”, following Mankiw and Whinston (1986)) or the positive effect it will have on inframarginal consumer surplus (Spence 1976). Policies that subsidize consumers or producers based on quantity will exacerbate both effects. We quantify the magnitudes of these welfare effects under the supply-side mandate and a counterfactual demand-side policy and determine the direction of the resulting effect empirically.²

We begin by showing descriptive evidence that the ZEV mandate has induced product entry. We document that a set of electric vehicle models were sold almost entirely in states with the mandate, and that these models were all designed on the platform of an existing gas-powered vehicle (“non-native”), instead of being designed from the ground up as an electric vehicle (“native”). Native vehicles sold in high quantities across the US; non-native vehicles sold in much lower quantities, and almost all had zero or low sales in states without the mandate.

To analyze social welfare and the incentives facing manufacturers, we estimate a model of consumer demand and producer price-setting in the 2009–17 US passenger vehicle market. We adopt a Berry, Levinsohn, and Pakes (1995)-style model of discrete choice demand, with differentiated products and heterogeneous consumer tastes, and Bertrand competition with multiproduct firms. We adapt the standard model to account for nationwide pricing and heterogeneity across states in environmental reg-

²Even a policy directly targeting the environmental externality, such as a carbon tax, may have ambiguous welfare effects when markets are imperfectly competitive and entry is endogenous (Fowle, Reguant, and Ryan 2016).

ulation. The estimated model parameters deliver estimates of markups over marginal cost and consumer surplus, and predict how these quantities change if products are not introduced. Combining these components using a static entry model, we compare the private benefits and social welfare effects of product entry, accounting for the business stealing externality, consumer benefits from variety, and environmental effects. We find that the social benefits of product entry for electric vehicles are positive and substantial: inframarginal consumers' tastes for variety exceed the business stealing externality and dwarf the short-run environmental effects. When regulatory credits are highly valued, the mandate can allow firms to capture up to half of these social benefits. To complete the welfare analysis, we use accounting estimates to bound the upfront cost of entry, and use observed entry behavior to estimate the benefits of entry that firms anticipate to capture in the long run, beyond the end of our study period.

We then simulate a counterfactual demand-side policy that replaces the ZEV mandate with a combination of a consumer subsidy for electric vehicles and consumer tax on non-electric vehicles. Without any change in the product set, the policy results in \$1.4 billion lower consumer surplus and \$570 million higher producer surplus. We then simulate the effect on product entry, accounting for the possibility of multiple equilibria. Across a range of entry scenarios, firms capture less of the social benefits of product entry under the demand-side policy. Allowing product entry to respond exacerbates the effect on consumer surplus, by reducing product variety: across entry scenarios, consumer surplus is between \$1.8 and \$1.4 billion lower under the demand-side policy. The effect on producer surplus is ambiguous, because of avoided upfront cost and foregone long-run benefits: between \$430 million and \$690 million higher. Because of the low sales of electric vehicles in this period, the environmental effects of both policies are small. These results imply that, though a mandate can induce producers to incur greater entry costs, it can also encourage product variety from which

consumers benefit. Our results suggest that state-level and national policymakers seeking to encourage the development and adoption of nascent socially beneficial products face different problems, and the choice of policy tool matters for state-level policy in ways that would not matter for national policy.

1.1 Literature

Industry observers have claimed that the ZEV mandate was influential in automakers' decisions to introduce electric vehicles,³ but the literature on the effects of electric vehicle policy has focused on other policies. This literature (reviewed most recently in Rapson and Muehlegger (2021)) has quantified the effects of purchase subsidies (Tal and Nicholas 2016; Jenn, Springel, and Gopal 2018; Muehlegger and Rapson 2018; Muehlegger and Rapson 2020; Remmy 2020; Xing, Leard, and Li 2021); public and private investment in complementary infrastructure, particularly charging stations (Li 2019); and a combination of both (Li, Tong, Xing, and Zhou 2017; Zhou and Li 2018; Springel forthcoming). An exception is Holland, Mansur, and Yates (2021), which evaluates a hypothetical cap-and-trade system to limit sales of gasoline vehicles over a long horizon.

To our knowledge, this paper is the first systematic welfare analysis of the ZEV mandate. Prior literature on the design and effects of the mandate from other perspectives, which has informed our modeling and our discussion of institutional features, includes Dixon, Porche, and Kulick (2002), Bedsworth and Taylor (2007), Vergis and Mehta (2012), Greene, Park, and Liu (2014), Linn and McConnell (2017), and McConnell and Leard (2021).

Our study of the ZEV mandate adds to an extensive literature on the effects of supply-side environmental policies in the automobile industry, which has focused primarily on fuel economy standards like the Corporate Average Fuel Economy (CAFE)

³See “Automakers question Calif. zero-emission mandate as feds reassess mpg rules” (Eric Kulisch, Automotive News, 12/12/17).

and state and federal greenhouse gas standards. Like the ZEV mandate, fuel economy standards simultaneously target pollution externalities (for which they are less efficient than a fuel tax (Sallee 2011b)) and market failures that result in too little innovation in equilibrium (Jaffe, Newell, and Stavins 2005). Unlike policies that target electric vehicles, which operate by supporting entirely new types of products, fuel economy standards operate by altering the mix of existing product types and encouraging improvements to existing technologies. This literature has documented effects of fuel economy standards on vehicle characteristics (Bresnahan and Yao 1985; Knittel 2011; Klier and Linn 2012; Whitefoot, Fowlie, and Skerlos 2017; Ito and Sallee 2018; Reynaert 2021) and equilibrium prices and quantities (Goldberg 1998; Goulder, Jacobsen, and van Benthem 2012; Jacobsen 2013; Davis and Knittel 2018), and estimated the costs of compliance (Anderson and Sallee 2011). This literature has typically contrasted standards with intensity-based policies like fuel taxes (Knittel 2012; Anderson and Sallee 2016).

The closest work to ours in the fuel economy standards literature is Durrmeyer and Samano (2018), which contrasts supply-side fuel economy standards and purchase subsidies within a structural model of demand and supply. In their setting, a standard that operates firm-by-firm induces a different shadow cost of regulation at each firm, while a purchase subsidy equalizes shadow costs across firms. Standards policies in which firms can trade credits, like CAFE since 2011, are equivalent to purchase subsidies in their setting.

Other work has examined the effects of purchase subsidies, particularly for hybrid vehicles in the early 2000s (Sallee 2011a; Beresteanu and Li 2011) and consumer subsidies and taxes to encourage fuel efficiency (Durrmeyer and Samano 2018; Durrmeyer forthcoming). Sallee (2011a) documents a difference between national demand-side and supply-side subsidies for the second-generation Toyota Prius, and argues for a mechanism based on dynamics in consumer perceptions.

Our study of the interaction between state-level policy and national prices connects to a literature on uniform pricing across markets, which has largely examined retail chains. This literature has shown that uniform pricing can increase profits under oligopoly (Adams and Williams 2019), and alters the equilibrium effects of local shocks and policies (DellaVigna and Gentzkow 2019; Leung 2021).

In studying the effect of regulatory mandates on the variety of products available in the market in equilibrium, we contribute to a literature on the determinants of equilibrium product variety and welfare effects of changes in product variety, both theoretical (Spence 1976; Mankiw and Whinston 1986) and empirical (Eizenberg 2014; Berry, Eizenberg, and Waldfogel 2016; Wollmann 2018; Fan and Yang 2020; Brand 2020). Like Petrin (2002), we quantify how much of the social surplus created by product entry is captured by firms.

Our computations of environmental damages build on a literature comparing the emissions of electric vehicles to those of their closest gas-powered substitutes (Holland, Mansur, Muller, and Yates 2016; Holland, Mansur, Muller, and Yates 2020; Muehlegger and Rapson 2020; Xing, Leard, and Li 2021), which has generally found that, during the early 2010s, electric vehicle adoption had a small effect on short-run pollution damages, and in some regions worsened them. Of these, Xing, Leard, and Li (2021) also uses a random coefficients discrete choice model to study the consequences of substitution between electric and non-electric vehicles.

2 Institutional background

Most major automakers in the US introduced an electric vehicle (EV) during the first generation of the commercial market in the early 2010s, but electric vehicle models varied widely in engineering characteristics and in sales levels. This generation of models fell mainly into two groups: models that were designed from the ground

up to be electric vehicles (called “native” vehicles within the industry) and models that used existing platforms from gas-powered vehicles (“non-native”). The native vehicles received upgrades during our study period, with longer ranges and increased efficiency, and usually had high sales. The non-native electric vehicles were typically not upgraded, typically had low sales, and dropped out of the market by 2021. (The one exception is the BMW i3, a low-sales model whose platform was designed from the ground up to support electric and plug-in hybrid versions.) Table 1 shows selected data for the electric vehicles available in the US in the period we study, covering model years 2009 to 2017. (The regulation was largely stable over this period. The period also covers the introduction of the first generation of electric vehicles in the US.)

Native electric vehicle platforms offer a superior combination of engineering characteristics, but cost more to develop and require dedicated production lines. In particular, a native electric vehicle has dedicated space for the battery pack, allowing for greater battery capacity and a more spacious interior than a vehicle that must fit a battery pack in a space designed for a internal combustion engine.⁴ Reasons manufacturers gave for opting for non-native electric vehicles included the lower upfront cost and the flexibility from making gas-powered and electric vehicles on the same production line.⁵ Non-native models also adopted the branding and design of the gas-powered vehicles they were based on.

The timing of the first generation of commercially available electric vehicles, most of which entered the US market between 2010 and 2015, has been attributed to rapid cost declines in lithium ion batteries driven by consumer technology applications, such as laptops and phones. Compared to nickel-metal hydride batteries, used by early

⁴See “What a teardown of the latest electric vehicles reveals about the future of mass-market EVs” (Antoine Chatelain, Mauro Erriquez, Pierre-Yves Moulière, and Philip Schäfer, McKinsey, 3/21/18).

⁵See “The Battery-Driven Car Just Got a Lot More Normal” (Bradley Berman, The New York Times, 5/4/12).

generations of the Toyota Prius and the short-lived GM EV1, lithium ion batteries offer much more usable charge for the same amount of weight, allowing for a longer electric range, and can charge and discharge more quickly.⁶ Tesla engineers have been credited with demonstrating that lithium ion batteries were feasible for electric vehicle applications.⁷

In this paper, we classify the major passenger vehicles available in this period into four technology types: conventional gas-powered vehicles with combustion engines (including flex-fuel ethanol); hybrids, which combine a combustion engine with a battery pack that cannot be charged externally; plug-in hybrids, whose battery packs are larger and can be charged externally; and battery electric vehicles. (Less commonly used technologies for passenger vehicles in this period include diesel, natural gas, and hydrogen.) We refer to plug-in hybrids and battery electric vehicles collectively as plug-in vehicles.

2.1 Policy of interest: ZEV mandate

The Zero Emission Vehicle (ZEV) mandate, adopted by California and nine other states,⁸ requires the largest automakers to sell a quota of non-fossil-fuel (“zero emission”) vehicles, nearly always battery electric vehicles.⁹ Each manufacturer’s quota is based on its past sales of all vehicles in the regulated states, and manufacturers can trade credits with each other and bank credits for later use. Industry observers have claimed that some low-sales electric vehicles, dubbed ‘compliance cars’, entered the market primarily to comply with the ZEV mandate. In our study period, six manufacturers faced the ZEV quota: Chrysler, Ford, GM, Honda, Nissan, and Toyota.

The number of credits earned for a battery electric vehicle is a function of the

⁶See “Car Industry: Charging up the Future” (Jeff Tollefson, *Nature*, 11/26/08).

⁷See “Plugged In” (Tad Friend, *The New Yorker*, 8/17/09).

⁸New York, Massachusetts, Vermont, Maine, Connecticut, Rhode Island, Oregon, New Jersey, and Maryland (starting 2011).

⁹Hydrogen fuel cell vehicles also counted generously toward the quota, but few were sold in this period.

range the vehicle can travel on a full battery; each manufacturer accumulates credits by selling vehicles, and the manufacturer's credit requirement is a percentage of its statewide sales of non-electric vehicles.¹⁰ For example, in California in model year 2017, Nissan earned three credits for each sale of the Leaf electric vehicle and faced a quota of 3,800 credits (3% of its California sales volume of 127,800), which translated to a quota of 1,300 Leaf vehicles. Nissan well exceeded this quota, selling 4,600 Leaf vehicles in California and 1,100 in the other nine states. (If its sales had fallen short, it could have drawn on its bank of 50,800 credits or purchased credits from another manufacturer.)

If an automaker missed its quota in any given year, it has two years to make up the deficit. After that point, in order to return to compliance, it is required to pay a penalty of \$5,000 per credit and also make up the deficit.¹¹

In this period, the requirement did not strictly apply state-by-state, but instead allowed each state's quota to be met with vehicles sold in any of the regulated states. This rule, called the travel provision, allowed automakers to earn credits in all regulated states for a sale in any of them. As a result, automakers could (and often did) meet their requirements only by selling vehicles in California, which had the largest population of the participating states, better charging infrastructure, and generous government subsidies to consumers.

In addition to the mandate on zero emission vehicles, the ZEV program included a mandate on clean gasoline vehicles, hybrids, and plug-in hybrids, collectively dubbed Partial Zero Emission Vehicles (PZEVs). The mandate applied to automakers that faced the ZEV mandate and an additional group of mid-sized automakers.¹² The ZEV and PZEV mandates were not entirely separate, as excess ZEV credits could

¹⁰Statewide sales of non-electric vehicles are constructed as a moving average of past years; see Section A.1 for details.

¹¹Between 2009 and 2017, no manufacturer was noncompliant. One manufacturer had a deficit that it made up the following year.

¹²Between 2009 and 2017, this group consisted of BMW, Daimler, Hyundai, Jaguar Land Rover, Kia, Mazda, Mitsubishi (2009 only), Subaru, Volkswagen, and Volvo (2009–11 only).

count toward the PZEV credit requirement. Nonetheless, each manufacturer’s sales of hybrids and clean gasoline vehicles each year was well over PZEV requirements, and there was little trading of PZEV credits among manufacturers. As a result, we assume that the Partial Zero Emission Vehicle mandate was not a binding constraint on any automaker.

Amendments to make the program stricter were announced in 2012 and took effect in model year 2018. The most important changes to the ZEV mandate were to reduce the number of credits earned per vehicle, add to the list of manufacturers who faced the ZEV quota,¹³ and replace the travel provision with a cross-state transfer mechanism that did not allow double-counting. In addition, the PZEV mandate was restricted to plug-in hybrids only. Manufacturers anticipating stricter post-2018 regulation may have earned surplus credits before 2018 in order to bank them.

2.2 Cost structure of electric vehicles

Electric vehicles have higher marginal costs than gas-powered vehicles, but the difference is falling throughout the period. Upfront costs of new native models are comparable to those of new gas-powered models, while upfront costs of non-native models are relatively low.

The marginal cost of a vehicle consists primarily of the labor and parts involved in assembly. Although electric vehicles have simpler powertrains than gas-powered vehicles, the resulting savings are dwarfed by the per-vehicle cost of the battery pack.¹⁴ This difference changed over time, however, as cost of a battery pack of a fixed size fell rapidly through this period. Figure 4 shows estimates of industry averages from BloombergNEF, which show a decline of 80% (in real terms) from 2011 to 2018.¹⁵

¹³This change added BMW, Daimler, Hyundai, Kia, and Volkswagen, by reducing the sales threshold at which the quota would apply.

¹⁴See “Making electric vehicles profitable” (Yeon Baik, Russell Hensley, Patrick Hertzke, and Stefan Knupfer, McKinsey, 3/8/19), which breaks down the difference in average cost.

¹⁵Estimates from other sources are roughly similar; see Nykvist and Nilsson (2015) and Ziegler

The upfront costs of introducing a new vehicle include the design of the vehicle platform, body, and powertrain; the engineering work required to pass safety tests and improve driver comfort; research and development; and the costs of retooling production lines. Industry estimates of the magnitude of these costs are around \$1 billion for native electric vehicles, and \$100–\$400 million for non-native electric vehicles.

The upfront cost of a new gas-powered model and platform is at least \$1 billion, and as high as \$6 billion if the engine and transmission are also new.¹⁶ Examining only redesigns of existing vehicle models, Blonigen, Knittel, and Soderbery (2017) estimate redesign costs ranging from \$850 million to \$3 billion, depending on vehicle class.¹⁷

Publicly available engineering estimates also put the upfront cost of a native electric vehicle near \$1 billion.¹⁸ In addition to final assembly, most electric vehicle makers, native and non-native, make the battery pack and motor in-house. Manufacturers vary in their choices to make or buy the other components.¹⁹ Because electric vehicles are mechanically simpler than internal combustion engines, requiring fewer parts and fewer assembly steps, the cost of developing a powertrain and setting up production is likely lower than for a gas-powered vehicle.

According to engineering estimates, the upfront cost of an electric vehicle built on an existing platform is much lower. We have three accounting estimates: first, the cost of the powertrain for the Toyota RAV4 EV; second, the research and development

and Trancik (2021) for comparisons.

¹⁶See “Why Does It Cost So Much For Automakers To Develop New Models?” (Terry Shea, Translogic, 6/27/10).

¹⁷Wollmann (2018) estimates sunk costs for commercial trucks using entry and exit behavior and finds much smaller amounts (\$5 to \$25 million). New truck models are usually adaptations of existing models and require less design work than new car models.

¹⁸See, for example, “Making electric vehicles profitable” (Yeon Baik, Russell Hensley, Patrick Hertzke, and Stefan Knupfer, McKinsey, 3/8/19), which compares the fixed costs of native and non-native electric vehicles.

¹⁹See “Trends in electric-vehicle design” (Mauro Erriquez, Thomas Morel, Pierre-Yves Moulière, and Philip Schäfer, McKinsey, 10/25/17).

(R&D) costs and capital investment for the Tesla Roadster (a non-native model which used the Lotus Elise chassis); and third, projections from Ford in 2015 of its future investments in its EV program. These estimates provide only rough guidance — in particular, they are from different times and represent different quantities — but together form an approximate range of reasonable figures, all of them much lower than the \$1 billion benchmark for a new gas-powered model. (These figures exclude earlier investments in the vehicle platform when it was only used for gas-powered cars.)

The cost of the powertrain for the Toyota RAV4 EV comes from a contract between Toyota and Tesla from 2010–12, in which Toyota agreed to pay Tesla \$60 million to develop the RAV4 EV powertrain.²⁰ Tesla would then manufacture the powertrain components in its own facilities and ship them to Toyota for final assembly. This suggests that it would have cost Toyota more than \$60 million to produce the RAV4 EV powertrain in-house, and provides a lower bound on the total cost to a major automaker of developing a non-native electric vehicle.

The R&D costs and capital investment for the Tesla Roadster prior to its introduction in 2010, as measured by accounting standards, totaled \$125 million.²¹ Tesla was one of a group of early electric vehicle startups developing non-native vehicles, and the first to sell a highway-capable vehicle to consumers. This estimate of upfront costs includes R&D costs that were likely unnecessary once electric vehicle design was more established, but also excludes the cost of setting up manufacturing beyond the initial rate of 50 cars per quarter.²²

Finally, in 2015, Ford announced it would invest \$4.5 billion between 2015 and 2020 to develop 13 EVs, of which some or all would use existing platforms, in addition

²⁰Source: 2012 Tesla 10-K.

²¹Source: 2010 Tesla 10-K.

²²See “Tesla Motors Announces 2008 Roadster Production Schedule and Achievement of Critical Milestones on Crash Tests and Range Testing” (press release, 4/20/10).

to the EV and hybrid program it already had.²³ This translates to an average upfront investment of \$350 million per model.

We argue that it is reasonable to extrapolate these estimates to other non-native electric vehicles in this generation for two reasons. First, general technological improvement over time was mainly in batteries, and so mainly affected marginal cost, not upfront cost. Second, these vehicles all had production volumes below mass-market levels, so manufacturers would have made similar choices for production scale. (Facing a product with a much higher volume, a manufacturer may choose to pay more upfront for optimizations that reduce marginal cost.)

2.3 Descriptive evidence

What is the relationship between the ZEV mandate and product entry? The main distinction that arises from the sales data is between native and non-native electric vehicles, as shown in Figure 1. Between their introduction and model year 2017, non-native EVs had 91% of their sales in states with the mandate; the figure for native EVs was 54%. In addition, except for the BMW i3, native EVs had much higher sales — 15,000 per year or more — while non-native EVs sell between 500 and 5,000 vehicles per year during the study period.

Though the decision to sell a vehicle primarily in states with the mandate suggests that the vehicle was likely not profitable without the mandate, the mandate was not the only difference between these groups of states. States with the mandate had denser charging stations and, often, more generous consumer incentives for EVs. We will use the demand model to disentangle the mandate from these factors.

In states with the mandate, did the buyers of native and non-native EVs differ along demographic characteristics? Figure 2 shows data from California buyers of electric vehicles who claimed rebates from the California Vehicle Rebate Program

²³Source: “Ford Investing \$4.5 Billion in Electrified Vehicle Solutions, Reimagining How to Create Future Vehicle User Experiences” (press release, 12/10/15).

between 2010 and March 2016, grouped into equal-sized bins by census tract median income.²⁴ (More recent data are difficult to interpret because the program instituted an income requirement in March 2016.) We divide vehicles into non-native, native non-Tesla (predominantly the Nissan Leaf), and Tesla. Though the share of EVs that are non-Tesla and native is roughly the same in higher- and lower-income areas, 47% of the EVs purchased by residents of areas in the lowest-income group (with a median income below \$56,000 per year) are non-native. This percentage falls to 20% in the highest-income group, with the difference made up by Tesla vehicles. The difference in Tesla adoption is not surprising — in this period, Tesla prices were \$60,000 or more — but the Nissan Leaf and most non-native vehicles were priced similarly in the low \$30,000 range. These results suggest that, if the ZEV mandate increased the entry of non-native electric vehicles, the benefits accrued mostly to consumers in lower- and middle-income areas.

3 Data

To study demand, we combine US new vehicle registrations by model and fuel type, product characteristics collected from various sources, and statistics from consumer surveys.

3.1 Product characteristics and sales

For sales, we use the universe of US new vehicle registrations in calendar years 2009 through 2017, obtained from IHS Markit (formerly R.L. Polk). This dataset contains the count of registrations for each model year, make, model, fuel type, and state. (In some cases, the dataset is further broken down by trim.) Our data contain both sales

²⁴Census tract median income from 2011–15 is drawn from the American Community Survey via the National Historical Geographic Information System (Manson, Schroeder, Van Riper, Kugler, and Ruggles 2020).

and leases; we treat both as sales. We use state-level data for the ten ZEV states, and aggregate the rest of the US into one region for our analysis.

For product characteristics, we combine trim-level data from MSN Autos, the US Environmental Protection Agency’s FuelEconomy.gov dataset, and Ward’s Automotive Yearbook, and supplement with additional sources where necessary. MSN Autos provides manufacturer suggested retail price (MSRP) and technical specifications, including size, horsepower, weight, and battery capacity. FuelEconomy.gov provides fuel economy data and the battery range for electric vehicles and plug-in hybrids. Ward’s Automotive Yearbook provides each model’s production location, and additional technical specifications that we use when MSN Autos data are missing. In addition, when battery capacity is not provided, we back it out from the federal IRC 30D subsidy amount (if possible) or obtain it from news sources. Like Reynaert (2021), we summarize fuel economy using the dollar cost (at time of purchase) of driving one mile, constructed by combining fuel economy data with average fuel prices by state and year from the US Energy Information Administration.²⁵ (Except for fuel costs and subsidies, product characteristics are the same across states.)

Our main dataset is restricted to gasoline, flex-fuel, electric, and hybrid vehicles with a gross vehicle weight rating under 8500 pounds, and whose base version has a MSRP under \$120,000. We remove products that were only sold to fleet or government buyers. We assume that a product without any sales in a given market and year was not offered in that market.²⁶ We restrict to model years 2009 through 2017. (Because we lack sales data before January 2009, we assume that the sales of model year 2009 vehicles in calendar year 2009 are a representative sample of all model year 2009 sales.)

We are interested in product differentiation that is technologically significant and

²⁵For plug-in hybrids, we weight electric and gas modes using the EPA utility factor.

²⁶This contrasts with Li (2019), who uses more granular markets and thus encounters products that were offered but had zero sales.

relevant to consumers, not small differences between trims of the same model. Therefore, we aggregate products to the level of model year, make, model, technology type (electric, plug-in hybrid, hybrid, gas) and battery size; within each group, we use the characteristics of the lowest-priced trim that accounted for at least 1% of the group’s national sales total.

For each vehicle’s price to consumers, we use MSRP minus a measure of manufacturer rebates derived from Automotive News²⁷ and federal and state government incentives. In the period we study, state government incentives generally went only to electric vehicles, plug-in hybrids, and hybrids; the only federal program that overlaps with the vehicle types we use was the tax credit for plug-in vehicles (IRC 30D). The IRS provides the federal tax credit amount for each vehicle model, and we collect state incentive amounts from government websites and the Alternative Fuels Data Center. We use nominal dollars throughout (including for household income, described below).

Table 2 shows summary statistics of our product characteristics data.

3.2 Demographics

Household demographics are taken from American Community Survey microdata²⁸ for 2009 to 2017. Demographics from a given calendar year t are matched to our market for model year t . The variables we use include income (in nominal dollars), location (Public Use Microdata Area), and college education. We exclude households with income below \$10,000. The market size we use is the number of households in each state and year, from American Community Survey 1-year estimates.²⁹

The county-level temperature factor demographic, which proxies for consumers’

²⁷We take the maximum consumer rebate observed in each quarter and average across quarters, and ignore manufacturer rebates to dealers. This roughly approximates the findings by Busse, Silva-Risso, and Zettelmeyer (2006) of high pass through for customer rebates and low pass through for dealer rebates.

²⁸Via IPUMS (Ruggles et al. 2019).

²⁹Because, on average, 77% of sales in model year t are made in calendar year t , we take the market size for model year 2009 (for which we are missing data from calendar year 2008) to be only 77% of U.S. households in 2009.

perceptions of the effects of extreme weather on battery performance, uses the formula from Holland, Mansur, Muller, and Yates (2016) and historical temperature data from the North American Land Data Assimilation System (via Holland, Mansur, Muller, and Yates (2016)’s replication files).

Micro-moments, which match consumers’ observable demographics to their vehicle choices, are drawn from surveys of vehicle purchasers. Data related to consumer location (for California buyers only) are drawn from the California Vehicle Rebate Program’s survey of rebate recipients, which matches the make and fuel type of a plug-in hybrid or electric vehicle to the census tract of the buyer. (We only use data before the program introduced an income requirement in March 2016.) Data on the education of electric vehicle buyers is drawn from summary tables in Xing, Leard, and Li (2021), which use the MaritzCX survey of new vehicle buyers.

3.3 Regulation

We estimate average ZEV credit prices by dividing the quantity of credits sold by Tesla, obtained from state regulators, by the revenue Tesla earned from those sales, as reported in quarterly filings and shareholder letters.³⁰ This accounts for a large part of the credit market: during this period, Tesla was the seller for 83% of the credits that were traded overall. We are unable to observe if the price paid per credit varies across buyers. We weight credits from different states equally because they were interchangeable under the travel provision. Table 3 shows our estimates of the prices of ZEV credits, along with Tesla’s share of total credit sales in the corresponding period.

The number of ZEV credits earned by each vehicle comes from public data from the California Air Resources Board and New Jersey Department of Environmental Protection.

³⁰This method has also been used by bloggers and (independently) by McConnell, Leard, and Kardos (2019).

We estimate the number of greenhouse gas regulation (GHG) credits earned by each vehicle using formulas from the regulation, fuel consumption from FuelEconomy.gov, and vehicle size data from MSN Autos. We assume a constant credit price of \$40 per megagram of CO₂, based on estimates summarized in Leard and McConnell (2017). In order to approximate the findings of Leard and McConnell (2017) that Corporate Average Fuel Economy (CAFE) standards were not binding on automakers while the GHG regulation was in effect, we set the CAFE credit price to zero during our study period. Prior to 2012, the GHG regulation applied differently in twelve states (the ZEV states plus Pennsylvania and Washington) than in the rest of the country; given our data limits, we approximate this by modeling GHG as applying only in the ZEV states.

3.4 Environmental damages

We use estimates from prior literature to determine CO₂ emissions per mile for different types of vehicles, and apply a social cost of carbon of \$41 per megagram. For electric vehicles, we use estimates by Holland, Mansur, Muller, and Yates (2016) of marginal emissions from electricity use by North American Electric Reliability Corporation (NERC) region, in megagrams of CO₂ per kilowatt-hour, which they estimate from 2010–2012 data. (When NERC regions do not line up with our geographical regions, we take an average, weighting each NERC region using average vehicle miles traveled from EPA MOVES.) We then convert to vehicle emissions using vehicle-specific electricity consumption per mile (in FuelEconomy.gov data). We determine CO₂ emissions per mile from gas vehicles by multiplying gasoline consumption per mile (in FuelEconomy.gov data) by 8887 grams of CO₂ per gallon (from EPA).

Section 4.3 describes how these emissions enter our welfare calculations.

4 Model

We combine a model of pricing and consumer choice each period with a static model of firm product entry decisions. At the beginning of the study period, prior to the entry of electric vehicles in the data, firms simultaneously choose which electric vehicles to enter. Then, in each model year, firms set prices and consumers choose which products to purchase.

To study consumer surplus and substitution among alternatives, we use a random coefficients logit model of consumer demand for automobiles. To estimate marginal costs, we use a Nash–Bertrand pricing model (featuring state-level markets and national pricing), with regulatory credits explicitly included in the profit function.

We also adopt a simple static model of product entry as a framework for measuring private entry incentives and comparing them to social welfare. We later use this model to predict entry under counterfactual policies.

4.1 Demand and pricing

Our analysis is built on a discrete choice model of demand for new vehicles in the vein of Berry, Levinsohn, and Pakes (1995) and Berry, Levinsohn, and Pakes (1999).³¹ In each region and model year, there is a population of consumers who each choose one product: either one of the gasoline vehicles, electric vehicles, and hybrids available in that region and model year, or an outside option, which captures the choice not to buy a new vehicle.³²

We assume that consumers do not respond to beliefs about future product availability or future changes to product characteristics or prices. We also do not model

³¹Papers with similar approaches to estimating automobile demand include Petrin (2002), Remmy (2020), Reynaert (2021), and Grieco, Murry, and Yurukoglu (2021), as well as Li (2019) (who only models the plug-in vehicle market).

³²This could include driving an existing vehicle for longer, buying a used vehicle, or forgoing car ownership.

state dependence: every consumer enters the market every period, and preferences do not depend on the vehicles the consumer already owns.

The discrete choice model we use also rules out capacity constraints or products with fixed production levels, which would induce unobserved variation in consumer choice sets as products become unavailable to late-arriving consumers. Our method is thus imperfect for Tesla, which used waitlists to manage the combination of high demand and production delays (like the second generation Toyota Prius, as documented in Sallee (2011a)). We do not observe waitlist entries, so our estimates subsume this process in the unobserved characteristic.

Let the set of geographical regions (states) be \mathcal{M} and index regions by $m \in \mathcal{M}$. The periods are model years, indexed by $t = 1, \dots, T$. Let the set of products available in region m and year t be \mathcal{C}_{mt} , and index products by j .

Demand. Indirect utility for consumer i in region m and model year t from purchasing product j is

$$u_{ijmt} = \alpha_i(p_{jt} - \text{subsidy}_{jmt}) + x_{jmt}\beta_i + \xi_{jmt} + \varepsilon_{ijmt}$$

where p_{jt} is the price of product j (set nationally), subsidy_{jmt} is the government subsidy for j in m , x_{jmt} is a vector of observed characteristics, ξ_{jmt} is a quality shock unobserved by the econometrician, and ε_{itmj} is a Type 1 Extreme Value shock distributed independently across consumers, alternatives, and markets. Indirect utility from purchasing the outside option, $j = 0$, is $u_{i0mt} = \varepsilon_{i0mt}$.

We parameterize taste heterogeneity as follows: $\alpha_i = \alpha/y_i$, where α is a parameter and y_i is consumer income;³³ and $\beta_i = \beta + \Pi d_i + \Sigma v_i$, where d_i is a vector of observed demographics, $v_i \sim N(0, I)$ is a vector of individual taste differences unobserved by

³³This approximation to a Cobb–Douglas-style indirect utility function is taken from Berry, Levinsohn, and Pakes (1999).

the econometrician (independent across consumers and independent of all observed variables), and Π and Σ are matrices of parameters. (We assume that Σ is a diagonal matrix. We also estimate a constrained specification where Σ is set to zero.)

Market shares in region m and year t are then given by

$$s_{jmt} = \int \frac{\exp(\alpha_i(p_{jt} - \text{subsidy}_{jmt}) + x_{jmt}\beta_i + \xi_{jmt})}{1 + \sum_{k \in \mathcal{C}_{mt}} (\alpha_i(p_{kt} - \text{subsidy}_{kmt}) + x_{kmt}\beta_i + \xi_{kmt})} dF_\theta(\alpha_i, \beta_i) \quad (1)$$

where F_θ is the joint distribution of (α_i, β_i) over the population of consumers in state m and model year t , indexed by the parameter vector $\theta = (\alpha, \beta, \Pi, \Sigma)$.

This specification assumes that consumers value a \$1 government subsidy and a \$1 reduction in price equally. This requires that consumers both know about subsidies (subsidies on electric vehicles are typically included in the price dealers advertise) and believe at the time of purchase that they will be able to take advantage of them.

The product characteristics that enter x_{jmt} are technical characteristics (horsepower-weight ratio, drivetrain), proxies for size (weight, number of doors, wheelbase, footprint), electric range and battery size for electric and plug-in hybrid vehicles, fuel costs per mile, an indicator for the first year a model is available, and fixed effects for fuel type, body style (sedan, SUV, truck, etc.), make, model year, and state. The demographics that enter d_i are a temperature factor capturing the frequency of extreme temperatures and an indicator for college education.

Pricing. We assume prices form a Nash equilibrium of a Bertrand game among multiproduct firms, who set national prices to maximize model-year profits.³⁴ We build on earlier models of the US auto industry by using market shares for separate geographic regions within the US, and explicitly modeling the effect of state and national regulations on the pricing decision. Our method assumes that marginal costs are the same across regions, so that the profit from a selling a vehicle only

³⁴See Appendix A.2 for evidence that national pricing is an appropriate model of the industry.

varies geographically due to differences in regulation. We assume that marginal costs do not depend on quantity, which rules out capacity constraints.

Consider a firm f with product set \mathcal{J}_{ft} . For each product $j \in \mathcal{J}$, the firm observes marginal cost mc_{jt} and the value of regulatory credits in each region v_{jmt} , then chooses its price p_{jt} . (We define v_{jmt} in the next section.) Let p_t be the vector of prices in year t . The firm's problem is

$$\max_{\{p_{jt}\}_{j \in \mathcal{J}}} \sum_{j \in \mathcal{J}_{ft}} \sum_{m \in \mathcal{M}} (p_{jt} + v_{jmt} - mc_{jt}) s_{jmt}(p_t) M_{mt} \quad (2)$$

where M_{mt} is the market size in region m in year t . The firm's first order condition with respect to p_{jt} is

$$0 = \sum_{m \in \mathcal{M}} \left(s_{jmt} + \sum_{k \in \mathcal{J}_{ft}} (p_{kt} + v_{kmt} - mc_{kt}) \frac{\partial s_{kmt}}{\partial p_{jt}} \right) M_{mt}. \quad (3)$$

Under these assumptions, the equilibrium price vector p_t is the joint solution to all firms' first order conditions.

Regulation. Selling an additional vehicle changes the firm's credit holdings under various national and state regulations, which we model using the v_{jmt} term in the profit function. Specifically, selling an alternative fuel vehicle earns credits under the greenhouse gas (GHG) and ZEV regulations, while selling a gas vehicle may increase the firm's total regulatory requirement. When the regulations are binding upon firms (that is, when credits have non-zero value) changes in credit holdings will enter the firm's per-period profit function.

In order to value this credit effect in firm profits, we take advantage of the data on credit prices described in Section 3.3. We treat firms as price takers in the market for regulatory credits, and we assume that accessing this market is costless for all firms.

Therefore, in equilibrium, all firms value the marginal credit at its market price.³⁵ If firms are certain about future credit prices, the mandate will operate as a producer subsidy and tax; with uncertainty, the results will generally differ (as in Weitzman (1974)). We will only consider scenarios where firms are certain about credit prices.

Specifically, we will consider two regulations, greenhouse gas (GHG) and ZEV.³⁶ Consider product j in region m and model year t .

Let $c_{jmt,GHG}$ and $c_{jmt,ZEV}$ be the net change in credits from selling one unit of j . To determine $c_{jmt,GHG}$, we take the difference between the vehicle's statutory emissions and its target (a year-specific function of vehicle footprint) and multiply by statutory expected vehicle miles traveled and multipliers for electric or plug-in hybrid vehicles. For electric vehicles, $c_{jmt,ZEV}$ is the number of credits earned (generally a function of electric range); for non-EVs sold by large manufacturers, $c_{jmt,ZEV}$ is the additional number of credits that must be surrendered when a non-EV is sold.³⁷

Now let $r_{mt,GHG}$ and $r_{mt,ZEV}$ be the value of each credit on the credit market. (When a regulation does not apply, such as ZEV outside of states with the mandate, we set this to zero.) Then the net value of regulatory credits earned from selling an additional unit of j in region m and model year t is

$$v_{jmt} \equiv c_{jmt,GHG}r_{mt,GHG} + c_{jmt,ZEV}r_{mt,ZEV}.$$

4.2 Static product entry model

We examine entry incentives using a static model in which a firm compares an upfront entry cost to two types of benefits: variable profit until some fixed date and the long-

³⁵In reality, the credit trading market is characterized by one large seller (Tesla, with 83% of sales) and a handful of buyers, including Toyota (37%), Ford (20%) and Fiat Chrysler (14%). We abstract away from the modeling issues that market power may present.

³⁶As described in section 3.3, we assume that CAFE standards were not binding in this period because of federal greenhouse gas regulation.

³⁷In our model, the number of credits a regulator requires the manufacturer to surrender is a fixed percentage of its non-EV sales that year. In practice, the number is a fixed percentage of a moving average of non-EV sales in prior years (as detailed in Section A.1).

run benefit of entry. We apply this framework to firm decisions to introduce electric vehicles, holding fixed the entry of non-electric vehicles by that firm and by other firms. We use the model and the observed pattern of entry to estimate lower bounds on the long-run benefit of electric vehicle entry, net of the entry cost. Using accounting data and further assumptions, we separate entry cost from long-run benefit. We then predict entry under counterfactual policies and determine the contribution of entry costs and benefits to welfare.

The entry cost captures the upfront investments that must be made when developing a new model, as described in Section 2.2. These include research and development, design, production line setup, and compliance with government safety standards. The long-run benefit of entry captures variable profit after the end of our study period and spillovers across projects within a firm. In rapidly developing technologies like electric vehicles, investments in early projects may lower the entry costs of later products. In addition, introducing a product in the US may lower that product’s entry costs in non-US markets.

The product entry decision is made once at the beginning of the study period, and then profits are collected throughout the study period. First, at $t = 0$, each firm simultaneously chooses whether to introduce each electric vehicle, and pays an entry cost for each introduction. Then, in each period $t = 1, \dots, T$, information is revealed and firms set prices and collect observed variable profits. At the end ($t = T$), each firm collects the long-run benefit for products it introduced. (Most firms only have one electric vehicle, or none. When a firm has multiple electric vehicles, we restrict the strategy space to withholding zero or one of the electric vehicles seen in our data.)

All firms share an information set \mathcal{I} at $t = 0$. (There is no private information.) In our main specification we assume that \mathcal{I} contains marginal costs and demand parameters, but not product quality ξ or credit prices r . (In our alternative specification, firms are only uncertain about credit prices.)

Credit prices r are endogenous to ξ because credit supply and demand depends on vehicle sales. We do not model credit prices directly, because firm values of credits depend on beliefs about the long-run trajectory of sales and policy. Therefore, we assume firms all have the same belief about r , and vary that belief across scenarios.

We assume that firms have complete information about costs. According to industry experts and trade press, firms believed in 2009 that battery prices were going to fall, though they may have disagreed on how quickly.

The payoff to firm f is the sum of variable profits until T and, for each product the firm introduces, the product's long-run benefit net of entry cost. Variable profits are obtained from the per-period profit function (2), which explicitly accounts for the effects of product entry on other products by the same firm. Let \mathcal{J}_{ft} be the set of products by firm f in period t and let $\mathcal{J}_{-f,t}$ be the set of products by other firms. Then profit for firm f in period t is

$$\pi_{ft}(\mathcal{J}_{ft}, \mathcal{J}_{-f,t}) = \sum_{j \in \mathcal{J}_{ft}} \sum_{m \in \mathcal{M}} (p_{jt}^* + v_{jmt} - mc_{jt}) s_{jmt}(p_t^*) M_{mt}$$

where p_t^* is the Nash equilibrium of the pricing game given the product set $(\mathcal{J}_{ft} \cup \mathcal{J}_{-f,t})$.

The remaining components are entry cost and expected long-run benefit. Both are allowed to vary across products, but are assumed not to depend on quantity or on the product set in the study period. As a consequence, the expected long-run benefit cannot capture the effects of policy changes on quantity-based outcomes like learning by doing.

Assumption 1 *For each product j , let $SC_j \geq 0$ be entry cost and $\delta^{-T}\pi_j^0 \geq 0$ be the expected long-run benefit collected at T . (The value of this benefit at $t = 0$ is therefore π_j^0 .) Then the firm's total expected payoff is*

$$\sum_{t=1}^T \delta^t E[\pi_{ft}(\mathcal{J}_{ft}, \mathcal{J}_{-f,t}) \mid \mathcal{I}] + \sum_{j \in \mathcal{J}_{ft}} (\pi_j^0 - SC_j).$$

To simplify notation, we write the present discounted value of the incremental variable profit from introducing product j as $\Delta_j \pi_f$:

$$\Delta_j \pi_f(\mathcal{J}_{ft}, \mathcal{J}_{-f,t}) = \begin{cases} \sum_{t=1}^T \delta^t (E[\pi_{ft}(\mathcal{J}_{ft}, \mathcal{J}_{-f,t}) - \pi_{ft}(\mathcal{J}_{ft} \setminus \{j\}, \mathcal{J}_{-f,t}) \mid \mathcal{I}]), & j \in \mathcal{J}_{ft} \\ \sum_{t=1}^T \delta^t (E[\pi_{ft}(\mathcal{J}_{ft} \cup \{j\}, \mathcal{J}_{-f,t}) - \pi_{ft}(\mathcal{J}_{ft}, \mathcal{J}_{-f,t}) \mid \mathcal{I}]), & j \notin \mathcal{J}_{ft} \end{cases}.$$

Putting those together, we can say the following about the product entry game: in equilibrium, no firm expects to benefit from introducing or removing a product from the product set. Therefore, if the firm introduces product j in equilibrium, the sum of incremental variable profit and long-run benefit must be larger than the entry cost.

Proposition 1 *If the product set in Nash equilibrium is $\mathcal{J}_{ft} \cup \mathcal{J}_{-f,t}$, then for any $j \in \mathcal{J}_{ft}$,*

$$\Delta_j \pi_f(\mathcal{J}_{ft}, \mathcal{J}_{-f,t}) + \pi_j^0 - SC_j \geq 0.$$

We will call $\Delta_j \pi_f(\mathcal{J}_{ft}, \mathcal{J}_{-f,t}) + \pi_j^0 - SC_j$ the private entry incentive.

To take this model to the data, we assume that all non-native EVs have the same ratio of long-run benefit to entry cost. This assumption captures that higher upfront investment in first-generation EVs may translate to larger cost savings in future generations of electric models. (Alternatively, we could interpret the long-run benefit as a discounted scrap value of exit; in a different setting, Wollmann (2018) models the scrap value of product exit as proportional to the sunk cost of entry.) Specifically, we assume that $\pi_j^0 = \kappa SC_j$ for all non-native EVs j and rewrite the private entry incentive as

$$\Delta_j \pi_f(\mathcal{J}_{ft}, \mathcal{J}_{-f,t}) - (1 - \kappa) SC_j.$$

As described in Section 7.2, we then use this condition to obtain an upper bound on

$(1 - \kappa)SC_j$ for each non-native EV that entered.

In reality, not all products are available in all periods. When taking this model to data, we treat the timing of delayed entry (or early exit) as fixed and known to the firm when it makes the entry decision. For products that were not sold in every state, we also treat the state-level pattern of entry as fixed.

4.3 Social welfare

We use a social welfare function to evaluate the effects of policy changes and to compare the equilibrium of the product entry game to the socially efficient pattern of entry. Total welfare combines consumer surplus, environmental effects, and producer surplus (which itself combines variable profit, long-run benefit, and entry cost).

When calculating welfare we exclude profits or losses from regulatory credits. A credit is not a socially useful asset, only a mechanism for firms to internalize environmental externalities that we have already accounted for.

In the exposition that follows, all quantities are present discounted values and the dependence on the product set is implicit. When taking to data, we use $\delta = 1$, and $t = 1, \dots, T$ corresponding to model years 2009 through 2017.

We define total welfare, denoted W , as

$$W = CS + Env + \sum_f (\pi_f - v_f) + \sum_j (\pi_j^0 - SC_j) \quad (4)$$

where CS is consumer surplus, Env is the negative of environmental damages, π_f is firm f 's variable profit, and v_f is firm f 's net profit from regulatory credits.³⁸ We account for long-run benefits to a given firm, but not long-run consequences for other firms (such as information spillovers across firms or future business stealing), long-run consumer surplus or environmental effects, or complementarities in entry costs across

³⁸That is, $v_{ft} = \sum_{j \in \mathcal{J}_{ft}} \sum_{m \in \mathcal{M}} v_{jmt} s_{jmt} (p_t^*) M_{mt}$.

products.

Environmental damages capture the CO₂ emissions from vehicles, and are calculated by assuming that every vehicle purchased is driven 150,000 miles over its lifetime.³⁹ We assume no deterioration in the gasoline or electric efficiency of the vehicle over time. Because we measure environmental damages at the time of purchase, we do not capture the time path of emissions or consumers' ability to respond to market conditions by driving their existing vehicles for longer. In particular, since the emissions from electricity use are changing rapidly over this period (Holland, Mansur, Muller, and Yates 2020) and electric vehicles are driven fewer miles each year (Davis 2019; Burlig, Bushnell, Rapson, and Wolfram 2021), we overestimate the damages of electric vehicles. We are also unable to measure the incremental emissions from a consumer's choice of the outside option; we assume the outside option has zero emissions.

4.3.1 Product entry and welfare

Using the product entry model, we ask whether the private incentives to introduce a product are aligned with the effect of product entry on social welfare. Each firm's product entry decision affects consumers, other firms, and the environment, and the total of these externalities can be positive or negative in equilibrium. By comparing these externalities and the incentives created by the mandate, we can determine how well the policy is aligning private incentives with social welfare.

The consumer and producer externalities that arise from our product entry model and social welfare function closely parallel Mankiw and Whinston (1986); we also include environmental externalities. For a given firm f , rewrite (4) to separate firm

³⁹This is lower than the statutory lifetime miles traveled in the GHG regulation, which is 195,264 miles for cars and 225,865 miles for light trucks.

f 's profit from the other terms:

$$W = \left(\pi_f + \sum_{j \in \mathcal{J}_f} (\pi_j^0 - SC_j) \right) - v_f + (\pi_{-f} - v_{-f}) + CS + Env + \sum_{j \notin \mathcal{J}_f} (\pi_j^0 - SC_j)$$

where $\pi_{-f} = \sum_{g \neq f} \pi_g$ and $v_{-f} = \sum_{g \neq f} v_g$.

To examine incremental changes in welfare components, we next define notation. Recall that $\Delta_j \pi_f$ is the difference in firm f 's profits with and without the introduction of product j . Analogously, let $\Delta_j(\cdot)$ be the difference in the value of a welfare component with and without the introduction of product j . If firm f chooses to introduce product j , the change in total welfare (given the rest of the product set) is given by

$$\Delta_j W = \underbrace{(\Delta_j \pi_f + \pi_j^0 - SC_j)}_{\text{private entry incentive}} - \Delta_j v_f + \underbrace{(\Delta_j \pi_{-f} - \Delta_j v_{-f} + \Delta_j CS + \Delta_j Env)}_{\text{sum of externalities}}.$$

Since π_j^0 and SC_j do not depend on the product set, the $\pi_j^0 - SC_j$ terms for all other products drop out.

This expression demonstrates that product introduction has externalities, whose total may be positive, negative, or zero. The $\Delta_j \pi_{-f}$ term is the negative effect of entry on other firms' profits, commonly called the business stealing externality (Mankiw and Whinston 1986); the $\Delta_j CS$ term is the consumer benefit from variety (Spence 1976); and the $\Delta_j Env$ term is the net environmental effect of consumer substitution from cleaner and dirtier alternatives.

Therefore, we assess the effects of a supply-side policy on entry incentives using the following criterion: whether the credit value (v) terms align private incentives with social welfare. If $\Delta_j v_f$ is equal to the sum of the externalities, then $\Delta_j W$ is equal to the private entry incentive and the firm fully internalizes the social welfare effects of product introduction. If $\Delta_j v_f$ is larger than the sum of the externalities, there may exist an incentive for inefficient entry; if $\Delta_j v_f$ is smaller than the sum of

the externalities, incentives for entry may be insufficient.

This criterion can be computed without estimates of entry costs and long-run benefits, because these terms are included in the private entry incentive. Without estimates of those terms, however, we cannot test whether the pattern of product entry is efficient.

5 Estimating the demand model

Identification of our demand model relies primarily on the assumption that the observed product characteristics are exogenous to unobserved quality ξ , which we implement using the differentiation instruments of Gandhi and Houde (2019). To estimate the coefficient on endogenous price, we also use government subsidies, cost shifters based on production locations, and (for electric vehicles and plug-in hybrids) a proxy for lithium ion battery costs. To recover heterogeneity in consumer tastes based on observed demographics, we add micro-moments from survey data as in Petrin (2002).

5.1 Instrumental variables

We assume that characteristics of all products are mean-independent of all products' quality shocks ξ .⁴⁰ We thus take each product's own characteristics as exogenous, and add the local differentiation instruments of Gandhi and Houde (2019). Specifically, for each product j and a subset of characteristics k ,⁴¹ we construct three instruments using PyBLP (Conlon and Gortmaker 2020): the characteristic value x_{jk} , the number of products j' by the same firm for which $x_{j'k}$ is within one standard deviation of x_{jk} , and the number of products j' by other firms for which $x_{j'k}$ is within one standard

⁴⁰According to industry experts, the technical characteristics of a vehicle are determined early in the design process. The electric range of non-native first-generation electric vehicles, for example, was typically determined by space constraints and the energy density of the battery chemistry used. See "What a teardown of the latest electric vehicles reveals about the future of mass-market EVs" (Antoine Chatelain, Mauro Erriquez, Pierre-Yves Moulière, and Philip Schäfer, McKinsey, 3/21/18).

⁴¹We use all characteristics except make, model year, and state fixed effects.

deviation of x_{jk} . As described by Gandhi and Houde (2019), the primary role of the differentiation instruments is to estimate random coefficient parameters.

We assume that government subsidies are exogenous.⁴² Subsidy levels are deterministic functions of vehicle characteristics, typically range or battery capacity; though the exact function varies over time, this is a response to changes in funding and not a response to the unobserved quality of particular vehicles. Subsidies do not depend on vehicle price, except some programs that exclude vehicles whose MSRP is above a cutoff level. (In practice, products are rarely priced close to the cutoff.)

For additional cost shifter instruments, we use the average manufacturing wage in the area of production (the 2009–17 average from the Quarterly Census of Employment and Wages),⁴³ and (for vehicles with a lithium ion battery) a proxy for the cost of the battery obtained by multiplying the battery size (in kilowatt-hours) and BloombergNEF’s measure of the industry-wide average battery pack price (in dollars per kilowatt-hour).

5.2 Micro-moments

We use two sets of micro-moments that help to identify demographic parameters in Π . The first matches electric vehicle purchases to county-level climate, using data from the California rebate program prior to 2016. We calculate a temperature factor, which proxies for consumers’ perceptions of the effects of extreme weather on battery performance, for each county. Then, for each model year (inferred based on purchase date) we calculate the mean temperature factor among buyers of electric vehicles. The second micro-moment, taken from Xing, Leard, and Li (2021), is the statistic that across model years 2010 through 2014, 81% of electric vehicle purchasers nationally had a college degree.

⁴²This instrument is also used by Li (2019).

⁴³This instrument is also used by Wollmann (2018).

5.3 Demand estimation method

We estimate demand parameters using a demand side-only version of the generalized method of moments estimator from Petrin (2002), implemented using PyBLP (Conlon and Gortmaker 2020). This estimator relies on two sets of assumptions: the exogeneity of the instrumental variables and the assumption that the model-predicted micro-moments match empirical values from survey data. Notation is as follows. For product j in state m and model year t , let z_{jmt} be a vector of instruments; stack the row vectors z'_{jmt} to form a matrix Z . Let $\xi(\theta)$ be the vector ξ which solves the system of market share equations (1) given parameters θ .⁴⁴ Defining $\mathbf{G}_1(\theta) = Z'\xi(\theta)$, the key assumption is that $E[\mathbf{G}_1(\theta)] = 0$. The micro-moments simply match the model's predictions of the moments from Section 5.2 to the values from data; defining $\mathbf{G}_2(\theta)$ to be the difference between model-implied moments and moments from data, the key assumption is that $E[\mathbf{G}_2(\theta)] = 0$.

Define $\mathbf{G}(\theta) = (\mathbf{G}_1(\theta), \mathbf{G}_2(\theta))$, and denote the sample analog of \mathbf{G} by $\hat{\mathbf{G}}$. The estimates are then computed by solving

$$\min_{\theta} \hat{\mathbf{G}}(\theta)' W \hat{\mathbf{G}}(\theta)$$

where W is a positive definite weight matrix.

We adopt many of the best practices in PyBLP recommended in Conlon and Gortmaker (2020). We solve the system of equations (1) using SQUAREM with the Berry, Levinsohn, and Pakes (1995) contraction map and tolerance 10^{-14} . We compute the integral over (d_i, v_i) using Monte Carlo integration with 200 draws per market. The weight matrix is determined by two-step GMM, clustering observations at the make-model level, and the minimization problem is solved using L-BFGS-B.

Standard errors are computed by the GMM formula, clustering observations at the

⁴⁴We assume that markets are large enough that observed market shares equal choice probabilities.

make-model level to allow for within-model correlation in unobserved quality across regions, across time, and across fuel type and battery size variants.

5.4 Demand estimates

Table 4 shows the estimated linear (β) and nonlinear (Π, Σ) parameters (except for the magnitudes of fixed effects). All else equal, consumers prefer vehicles that are gas-efficient, but are relatively insensitive to electric efficiency. Consumers on average dislike hybrids and electric vehicles, but have heterogeneous preferences.

Because we obtain estimates of Σ that are close to zero, we also estimate a constrained model that sets $\Sigma = 0$, so that all heterogeneity across consumers comes from observed demographics. We use the constrained model for the estimates and counterfactuals that follow.

6 Estimating the pricing model

We estimate marginal costs by solving the Nash–Bertrand first order conditions (3). This method is an adaptation of the method in Berry, Levinsohn, and Pakes (1995) to accommodate national pricing and state variation in regulation, and relies only on prices, quantities, and demand elasticities.

6.1 Marginal cost estimates

The demand estimates and the additional assumption of the pricing model together give estimates of marginal cost. Figure 3 shows trends in sales-weighted average prices and estimated marginal costs for non-Tesla electric vehicles. Marginal costs fall until 2015, and then rise; the rise is mainly attributable to increases in the battery pack size in later-model EVs. The trend of declining marginal cost is consistent with the falling battery prices in this period described in Section 2.2 and shown in Figure 4.

7 Estimating product entry incentives

Interpreting our estimates of welfare using the static product entry framework described in Section 4.2, we find that the mandate allowed firms to capture 25–50% of the externalities of entry, as opposed to less than 10% under the greenhouse gas program alone. Comparing accounting estimates of entry costs with observed variable profit, we estimate a long-run benefit for non-native electric vehicles of at least 78% of entry cost.

7.1 Social welfare and entry incentives

As discussed in Section 4.3.1, we can use the demand and pricing model to test whether the credit value is properly aligning private entry incentives with the social welfare effects of entry. If the incremental value of credits is close to the sum of the product entry externalities, then the firm is internalizing those externalities when choosing product entry.

We quantify the three externalities — business stealing, consumer surplus, and environmental effects — and compare them to incremental credit value $\Delta_j v_f$ under various assumptions about credit prices. To do so, for each electric vehicle j , we predict changes in consumer surplus and market shares if j is dropped. (We hold prices fixed for simplicity.) Business stealing then comes from other firms’ profits, computed using marginal cost estimates and the predicted shares. Environmental effects come from predicted changes in shares (as described in Section 4.3).

In our baseline specification, we assess the incentives under full information about ξ , using each product’s estimated ξ from the demand model. In our alternative specification, firms choose entry without knowing product quality in advance; they instead take an average over the distribution of ξ , which we approximate using a normal distribution. In both specifications, we try three paths for r : no ZEV mandate

($r_{mt,ZEV} = \$0$), the observed realization of $r_{mt,ZEV}$, and a scarce-credit scenario ($r_{mt,ZEV} = \$5000$). (We do not consider specifications in which firms are uncertain about r .) We assume the credit price for GHG remains fixed.

We estimate that the sum of the externalities is positive for all products. That is, there are social benefits from product entry that are not internalized by private firms in the absence of regulatory credits. In all cases, consumer surplus is the positive externality, business stealing is negative but smaller, and the environmental benefit is small in absolute value and sometimes negative. The small environmental benefit reflects both the low sales of electric vehicles and the implication of our demand estimates that the closest substitutes for electric vehicles are other electric or clean vehicles.

The percentage of the externality captured by credit values is given in Figure 5 for each product. GHG credits alone make up about 10% of the entry externalities; under realized ZEV prices, 25–50% of the externality is captured by credit values. Even in the \$5000 ZEV credit scenario, most firms do not internalize the full benefits of product entry.

When the welfare calculations are averaged over ξ , the gap between credit values and the sum of externalities is wider. GHG credits alone make up 9–17% of entry externalities, while in the \$5000 ZEV credit scenario, credit value is still only 25–45% of the sum of entry externalities.

7.2 Estimation of product entry parameters

We estimate bounds on product entry parameters in order to predict product introduction under counterfactual policies and measure total welfare. By assuming the entry pattern observed in the data is a Nash equilibrium of the product entry game described in Section 4.2, we can estimate the difference between entry cost and

long-run benefit.⁴⁵ To separate these terms, we use the accounting estimates from Section 2.2 to bound entry costs.

For any non-native electric vehicle model j , let $f(j)$ be the firm that produces product j . Proposition 1 gives an equilibrium strategy that depends on unobserved variables and variables that can be estimated from the demand model:

$$\text{enter if } (1 - \kappa)SC_j \leq \Delta_j \pi_{f(j)}.$$

To estimate expected incremental variable profit $\Delta_j \pi_{f(j)}$, we compare firm profits in the observed equilibrium (obtained from the demand model) with profits in the scenario in which j is dropped and market shares adjust. We try three paths for r , as described in Section 7.1. To reduce the computational burden, we hold prices fixed.⁴⁶

Using these estimates for all non-native EVs, we can obtain a lower bound on κ , the ratio of expected long-run benefit to entry cost. This estimate uses only the incremental variable profit of the least profitable product and the lower bound on entry cost. When incremental variable profit falls short of entry cost, the long-run benefit required to justify entry is larger, giving a higher implied lower bound on κ . By contrast, if incremental variable profit is higher than entry cost, entry can be rationalized by any value of $\kappa \geq 0$.

Consider $j \in \mathcal{J}_{NN}$, the set of non-native (“NN”) electric vehicle models that enter before 2017. Let $[\underline{SC}_{NN}, \overline{SC}_{NN}]$ be the range of accounting estimates. Then, for each $j \in \mathcal{J}_{NN}$,

$$(1 - \kappa)\underline{SC}_{NN} \leq (1 - \kappa)SC_j \leq \Delta_j \pi_{f(j)},$$

⁴⁵Our approach is an application of the framework in Pakes, Porter, Ho, and Ishii (2015), and has elements in common with Wollmann (2018).

⁴⁶Incorporating equilibrium price changes is in progress.

giving a lower bound on κ , which we denote $\underline{\kappa}$:

$$\kappa \geq \underline{\kappa} \equiv 1 - (\underline{SC}_{NN})^{-1} \min_{j \in \mathcal{J}_{NN}} \Delta_j \pi_{f(j)}.$$

That is, the long-run benefit for the least profitable product observed in the data must be large enough to recover the lowest possible entry cost.

Because we do not have data on products that were not introduced, we are unable to use entry behavior to estimate an upper bound on κ . For the non-native models introduced early in our study period, we assume that $\kappa \leq 1$. (For products where $\Delta_j \pi_{f(j)}$ is positive, the equilibrium condition generates the same prediction for $\kappa = 1$ and $\kappa > 1$.)

Given a particular value of κ , the entry rule also implies an upper bound on SC_j for each product j that entered: $SC_j \leq (1 - \kappa)^{-1} \Delta_j \pi_{f(j)}$.

7.3 Product entry parameter estimates

We begin by estimating incremental variable profit for each electric vehicle j using the demand and supply model. These estimates are shown in Figure 6, where they are compared to accounting estimates of entry cost. While all native models except the BMW i3 recover their entry cost without long-run benefits, about 40% of non-native models do not, with expected incremental variable profits as low as \$50 million (as compared to entry costs that start at \$100 million).

These figures are generally robust to the inclusion of unobserved product quality ξ in firm information sets, but the identities of the lowest-profit products depends on which information set is assumed. For example, the Mercedes and Ford models have high expected incremental variable profits based on observable characteristics and costs, but low realized values of ξ that cause the realized incremental variable profits to be much lower.

We next estimate a lower bound on κ for non-native EVs. From accounting estimates, we use $\underline{SC}_{NN} = \$100$ million. Under the realized credit price path, the lowest expected incremental variable profit is \$47 million when ξ is not conditioned on, and \$22 million when ξ is conditioned on. (We exclude products that entered during model year 2017.) Therefore, we obtain $\underline{\kappa} = 0.53$ when ξ is not conditioned on, and 0.78 when ξ is conditioned on.

8 Counterfactual demand-side policy

What are the welfare effects of achieving the same quantity target by a demand-side policy? We simulate the effects of replacing the ZEV mandate with a counterfactual policy that only uses consumer incentives.⁴⁷ In particular, we eliminate ZEV credits and add (1) a consumer subsidy for electric vehicles in the ten regulated states, plus (2) a consumer tax on non-electric vehicles in the ten regulated states. By simulating the new equilibria of pricing and product entry, we measure the welfare effects of changing to the counterfactual policy.

Under national pricing, a subsidy for consumers in one region will introduce a difference between the consumer price in that region and the consumer price elsewhere, while a subsidy for producers in a region will not. When a firm adjusts its price in response to the subsidy, its incentives are different when this difference is present than when it is absent, in turn creating different markups and incentives for product entry.

We set the specific level of the subsidy and tax by targeting two outcomes: electric vehicle quantity and budget balance. First, the policy must achieve the same total electric vehicle sales each year across the ten regulated states as observed data. Second, the policy must be budget-balanced: total expenditure on the subsidy must

⁴⁷This type of policy is known as a ‘feebate’, and is commonly used to control greenhouse gas emissions from cars. A greenhouse gas-based feebate system was proposed in California in 2008, but not passed (Durmeyer and Samano 2018).

equal total collection through the tax, across all of the regulated states. We adopt total electric vehicle sales as the target because it is easily measured and explicitly mentioned as a goal in regulator reports.

To account for the effect of the subsidy and tax on consumer prices, we recompute the Nash–Bertrand price equilibrium by iterating equations (3) until a fixed point is reached.⁴⁸ This computation requires the subsidy and tax to be set simultaneously with prices, and the regulator to have the same amount of information as the firms.

The structure of the counterfactual policy mimics that of the ZEV mandate, but minor differences remain. The subsidy amount follows the ZEV formula for credits per vehicle, generating a larger subsidy for vehicles with a longer battery range. Unlike the ZEV mandate’s quota, which only applies to large automakers, the consumer tax applies to all non-EVs sold in the ten regulated states. In addition, while the ZEV mandate allows firms to smooth out the policy over multiple years using credit banking, there is no similar mechanism to smooth out the consumer subsidy.

To assess the effect of product entry, we compute these subsidy and tax levels under a variety of plausible entry scenarios. For each scenario, we then test whether the scenario could be an equilibrium in the product entry game, by checking if any firm can profitably deviate in its EV entry decision. In computing producer surplus, we report a range of estimates given the bounds on entry cost and long-run benefit from Section 7.3.

Formally, the setup is as follows. The policymaker controls the subsidy τ_t^0 and tax τ_t^1 for each model year t . For product j in region m and model year t , let q_{jmt}^0 be the quantity sold in the data. Let $e_j = 1$ if product j is an electric vehicle and 0 otherwise, let c_j be a subsidy multiplier (equal to the number of credits j earns under the ZEV mandate) and let $z_m = 1$ if region m has the regulation and 0 otherwise. The net consumer subsidy for purchasing j in m and t (in addition to existing subsidy

⁴⁸Conlon and Gortmaker (2020) document that this method is not guaranteed to converge; in our case, it does.

programs) is $z_m(\tau_t^0 c_j e_j - \tau_t^1(1 - e_j))$. Let $q_{jmt}(\tau_t^0, \tau_t^1)$ be the quantity sold under the demand-side policy, which depends implicitly on price adjustment. The sales constraint is therefore

$$\sum_m z_m \sum_j e_j (q_{jmt}(\tau_t^0, \tau_t^1) - q_{jmt}^0) = 0,$$

the budget balance constraint is

$$\sum_m z_m \sum_j (\tau_t^0 c_j e_j - \tau_t^1(1 - e_j)) q_{jmt}(\tau_t^0, \tau_t^1) = 0,$$

and the policymaker chooses (τ_t^0, τ_t^1) to solve this system of equations.

8.1 Results

We begin by measuring the effects of the demand-side policy if the product set is held fixed. The required consumer subsidy is larger than the value of a corresponding ZEV credit, and relative prices adjust in a way that lowers consumer surplus and raises total variable profit. We then turn to the effects of the demand-side policy on entry incentives. We measure the additional consumer surplus loss from the reduced product variety. Across the equilibria that are supported by our estimates of product entry parameters, the effect of endogenous entry on producer surplus ranges from a small negative effect to a small positive effect. In some equilibria, foregone long-run benefits exceed avoided entry costs, but in others they do not.

8.1.1 Without entry margin

The left panel of Table 5 shows the magnitude of the consumer subsidy and tax that implement this policy. The subsidy amount varies from \$2,300–\$3,600 before range multipliers, which is substantial and larger than the ZEV credit prices in Table 3.

This amount translates to \$7,000–\$10,700 per vehicle for a Nissan Leaf. (Because of the small market share of electric vehicles, the tax on non-EVs is under \$150 per vehicle.) This additional subsidy is on top of the \$7,500 federal tax credit and existing state rebates (\$2,500 in California).

The main effect of the policy is to raise EV prices outside the regulated states, as the ZEV mandate no longer exists to hold down national prices. In the ZEV states, net consumer prices (after subsidies) are higher for the products that are only sold in ZEV states, and lower for the products that are sold nationally. Price comparisons for EVs, in California and the non-ZEV states, are shown in Figure 7.

Without any change in the product set, the price changes resulting from the switch to a demand-side policy result in \$1.4 billion lower consumer surplus and \$570 million higher producer surplus.

8.1.2 Social welfare and entry incentives

We next measure how much the firm captures of the externalities of product entry (consumer surplus, avoided environmental externalities, and changes in other firms' surplus, as described in Section 7.1). For each product j , we drop the product from the choice set, let market shares adjust (holding fixed GHG credit prices, the subsidy, and prices), and compute the difference in consumer surplus and profits. The sum of entry externalities stays constant or rises slightly; because the credit term no longer includes ZEV credits, a smaller portion of the externalities is being captured.

We repeat this calculation across scenarios in which the n lowest-selling non-native electric vehicles stay out of the market. Figure 8 shows the uncaptured social benefit, measured as the sum of the externalities of product entry minus the private gain from GHG credits. Across all the entry scenarios we consider, the uncaptured benefit is larger under the demand-side policy than under the mandate.

8.1.3 With entry margin

If the demand-side policy induces firms to capture less of the social benefits of product entry, we may expect fewer products to enter. Given a value of entry cost and long-run benefit, we can test a product entry scenario by computing whether any firm has an incentive to deviate: either it has a product which is out but faces a positive entry incentive, or a product which is in and faces a negative entry incentive. We use the simplified model in Section 7.3, and adopt the specification in which product quality ξ is in all firms' information sets.

Over a range of values of $\kappa \in [\underline{\kappa}, 1)$, we test whether a given scenario is a potential equilibrium by examining whether any firm has an incentive to deviate by entering or removing a single product. (We do not consider the hypothetical entry of products that were not observed in the data.) We do so by comparing the counterfactual incremental variable profit of the product, which we write $\Delta_j \pi_{f(j)}^{cf}$, against the entry cost net of long-run benefit, $SC_j(1 - \kappa)$. Because we do not observe SC_j , we use the bounds derived in Section 7.3, and use the data to assign $d_j(\kappa) \in \{\text{in}, \text{out}, \text{unknown}\}$ as follows:

$$\begin{cases} \text{out,} & \Delta_j \pi_{f(j)}^{cf} < \underline{SC}(1 - \kappa), \\ \text{in,} & \Delta_j \pi_{f(j)}^{cf} > \min\{\overline{SC}(1 - \kappa), \Delta_j \pi_{f(j)}\}, \\ \text{unknown,} & \text{otherwise} \end{cases}$$

For each κ , we then say that the scenario is rejected if any product is out and has $d_j(\kappa) = \text{in}$, or the product is in and has $d_j(\kappa) = \text{out}$. (In this computation, we ignore incentives to deviate by products that were only introduced in 2017.)

Figure 9 shows the results. Across the entry scenarios in which the n lowest-selling non-native electric vehicles stay out, the scenarios with $n = 8, 9, 10, 11$ are rejected for all $\kappa \in [\underline{\kappa}, 1)$. The remaining scenarios are rejected for some values of κ .

Subsidy and tax amounts. In order to replace the lost sales from the models that stay out, the incentive for EVs needs to be increased. The right panel of Table 5 shows the subsidy and tax in the scenario in which four (of eleven) non-native electric vehicles stay out of the market. The subsidy is up to 27% higher than in the scenario where the product set is unchanged.

Effects on welfare. Reduced product variety decreases consumer surplus, variable profit for producing firms, and total entry costs, but increases variable profit for non-producing firms. The environmental effects of reduced variety depend on whether consumers who would have purchased the electric vehicles that did not enter instead purchase more- or less-polluting alternatives. The effects of the subsidy and tax on welfare are theoretically ambiguous.

We quantify welfare effects using the simplified model of product entry and total welfare from (4), and the ratio of long-run benefit to entry cost ranging from $\underline{\kappa} = 0.78$ to 1. We assume that entry costs and long-run benefits do not change, for simplicity.

Let π_f^{cf} be firm f 's counterfactual variable profit, and let \mathcal{J}_f^{cf} be firm f 's counterfactual product set. The difference in producer surplus combines the difference in variable profit, avoided entry costs, and foregone long-run benefits:

$$\sum_f \left(\pi_f^{cf} - \pi_f + \sum_{j \in \mathcal{J}_f \setminus \mathcal{J}_f^{cf}} SC_j (1 - \kappa) \right).$$

Because we do not have point estimates of SC_j or κ , we hold κ fixed and compute bounds on the difference in consumer surplus. For each $\kappa \in [\underline{\kappa}, 1]$, we use $SC_j \in [\underline{SC}, \min\{\overline{SC}, (1 - \kappa)^{-1} \Delta_j \pi_{f(j)}\}]$.

The results across the range of entry scenarios we consider are shown in Figure 10. For each κ , we calculate the maximum upper bound and minimum lower bound on producer surplus across the scenarios that are not rejected, and the maximum and

minimum of non-producer welfare (consumer surplus and environmental damages) across the same scenarios.

When long-run benefits are very low, producers gain by avoiding entry costs, while consumers lose from reduced variety. When long-run benefits are at the level implied by observed entry, $\kappa \geq \underline{\kappa}$, consumer surplus is between \$1.8 and \$1.4 billion lower and producer surplus is between \$430 million and \$690 million higher, for a total loss of between \$1.3 billion and \$750 million from switching to the demand-side policy. When long-run benefits are high, there is no response on the entry margin.

9 Conclusion

We examine the effects of the ZEV mandate, an influential state-level supply-side environmental policy in early generations of the US electric vehicle market. The mandate allowed entrant firms to capture more of the social surplus generated by their products. Because of the interaction between national pricing and regional policy variation, the mandate generated higher consumer surplus and lower producer surplus than a comparable demand-side policy would have, and likely induced more entry and greater product variety. These findings have consequences for future state policies to encourage new, socially beneficial types of consumer products within national markets. Though electric vehicle product variety, costs, and quantities have evolved significantly since the period we study, our findings may also have implications for the welfare consequences of current and future electric vehicle policy.

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10 Tables and figures

Model	Native?	Introduced	Sales (to 2017)	Price	Range (mi)
Ford Focus		2012	9,000	\$26,437–\$38,138	76–115
Mitsubishi i-MiEV		2012	2,000	\$22,995–\$29,125	59–62
Toyota RAV4		2012	2,000	\$48,967–\$49,717	103
Fiat 500e		2013	24,000	\$29,467–\$32,120	84–87
Honda Fit		2013	1,000	\$36,625	82
smart fortwo		2013	6,000	\$23,488–\$25,000	58–68
Chevrolet Spark		2014	7,000	\$22,870–\$26,685	82
Mercedes-Benz B-Class		2014	4,000	\$39,900–\$41,450	87
Kia Soul		2015	5,000	\$30,450–\$33,700	93
Volkswagen e-Golf		2015	12,000	\$28,538–\$33,450	83–125
Hyundai Ioniq	*	2017	<1,000	\$29,500	124
Nissan LEAF	X	2011	114,000	\$27,010–\$35,200	73–107
Tesla Model S	X	2012	113,000	\$57,400–\$135,000	139–315
Tesla Model X	X	2016	32,000	\$74,000–\$145,000	200–289
Chevrolet Bolt EV	X	2017	23,000	\$36,453	238
Tesla Model 3	X	2017	1,000	\$35,000	310
BMW i3	X*	2014	8,000	\$40,692–\$42,400	81
Honda Clarity	X*	2017	1,000	\$36,620	89

Table 1: Summary of electric vehicles in the US in 2009–17

Note: Compiled from MSN Autos and IHS data. Prices are MSRP after average manufacturer rebates.

All years are model years. Native designation assigned by authors based on press reports. *EV and hybrid/plug-in hybrid versions developed jointly on the same platform.

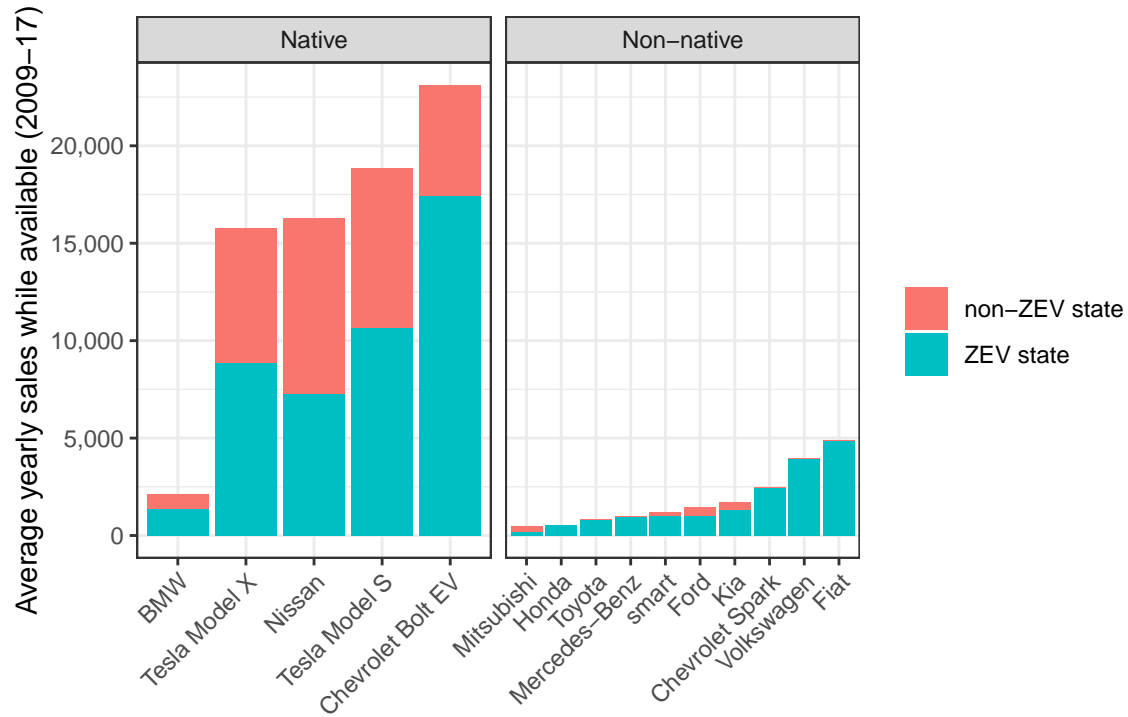


Figure 1: Average yearly sales by model, selected EVs, by ZEV states and non-ZEV states
Note: Derived from IHS data. Average is only taken over the years the model was available. Native vs. non-native classification assigned by authors from news reports.

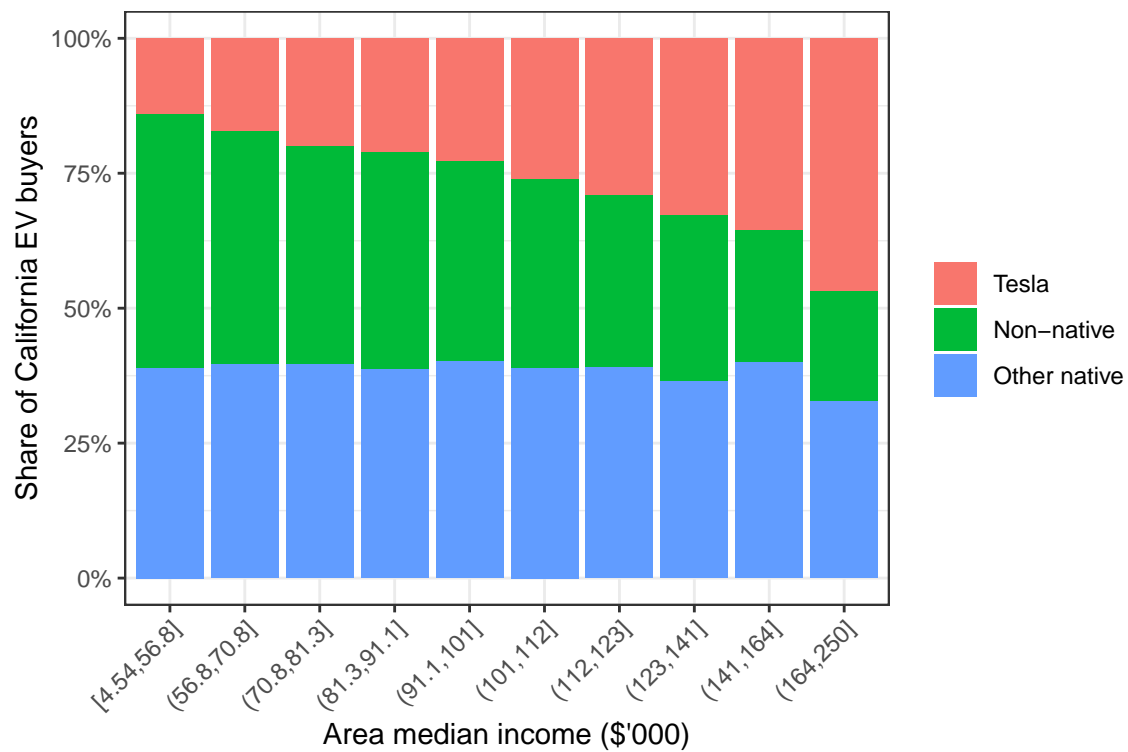


Figure 2: Breakdown of EV sales by non-native, Tesla, and other native, by census tract median income (California, 2010–16)

Note: Derived from California Vehicle Rebate Program survey data from inception to March 2016. Buyers are divided into ten equally sized groups by census tract median income.

	Min	Max	Mean	Sales-weighted mean	SD
Model year	2009.00	2017.00	2013.14	2013.52	2.61
Products per market	240.00	332.00	286.42	296.81	20.94
Inside good share	0.05	0.18	0.12	0.12	0.03
Price	7969.17	145000.00	36687.69	24948.22	21394.87
Govt subsidy	0.00	12500.00	305.02	47.33	1442.06
Doors	2.00	5.00	3.72	3.71	0.81
Weight (lbs)	1808.00	6000.00	3827.84	3649.65	821.03
Footprint (sq ft)	25.78	68.70	48.04	48.37	5.60
Wheelbase (in)	73.50	145.70	110.16	110.47	8.73
New model	0.00	1.00	0.09	0.05	0.28
HP/Weight	0.03	0.19	0.06	0.06	0.02
Displacement (cc)	0.00	8390.00	2957.67	2769.29	1242.60
Hybrid	0.00	1.00	0.09	0.03	0.28
PHEV	0.00	1.00	0.02	0.00	0.14
EV	0.00	1.00	0.02	0.00	0.14
Battery (kWh)	0.00	100.00	1.00	0.17	6.49
Electric range	0.00	315.00	3.17	0.54	21.43
Gas cost/mi	0.00	0.33	0.13	0.12	0.05
Electric cost/mi	0.00	0.09	0.00	0.00	0.01

Table 2: Summary statistics, vehicle characteristics and sales data

Note: Compiled from data from MSN Autos, FuelEconomy.gov, Ward’s Automotive Yearbook, and IHS. Prices are MSRP after average manufacturer rebates. All years are model years.

Window	Revenue (m)	Credits	Avg credit price	Tesla share
2010Q4—2013Q3	\$166	45,617	\$3,630	67%
2013Q4—2014Q3	\$86	35,869	\$2,400	71%
2014Q4—2015Q3	\$170	87,243	\$1,950	70%
2015Q4—2016Q3	\$204	85,098	\$2,390	92%
2016Q4—2017Q3	\$120	82,584	\$1,460	89%

Table 3: Estimated credit prices

Note: This table shows the computation of the average price of ZEV credits sold by Tesla in each year. Tesla’s revenue from credit sales comes from Tesla’s quarterly reports and shareholder letters. The number of credits sold by manufacturer by year was obtained from state regulatory agencies in the ten ZEV states.

	Demographics		Full	
	Estimate	SE	Estimate	SE
Linear parameters (β)				
Displacement (L)	0.24	0.07	0.23	0.07
Doors	-0.21	0.09	-0.20	0.09
Wheelbase	-0.03	0.02	-0.03	0.02
HP/Weight	-4.17	5.17	-4.29	5.23
Weight (tons)	-0.60	0.40	-0.65	0.41
Gas cost/mi	-14.82	2.13	-14.46	2.16
Electric cost/mi	-41.04	1.88	-0.41	2.40
PHEV Range	0.01	0.02	0.01	0.02
EV Range	-0.02	0.02	-0.01	0.02
Battery (kWh)	0.06	0.05	0.02	0.06
Footprint	0.12	0.04	0.12	0.04
New model	-0.01	0.07	-0.01	0.07
Hybrid	-2.33	0.18	-2.33	0.18
PHEV	-1.73	0.40	-2.55	0.41
EV	-6.42	8.91	-10.62	10.02
Coupe	0.67	0.24	0.66	0.25
Hatchback	0.56	0.33	0.57	0.33
SUV	1.88	0.31	1.87	0.32
Sedan	1.38	0.30	1.37	0.31
Truck	1.00	0.39	0.99	0.40
Van	1.12	0.42	1.06	0.44
Wagon	0.94	0.39	0.93	0.39
FWD	0.46	0.17	0.47	0.17
RWD	0.06	0.14	0.09	0.15
Demographics (Π)				
(price-subsidy)/income	-8.27	3.29	-8.09	3.36
EV*College	1.08	0.22	1.08	0.47
EV*Temp. Factor	4.75	9.52	7.18	10.61
Unobserved heterogeneity (Σ)				
(constant)			0.00	2.92
EV			0.00	4.62

Table 4: Estimates of demand parameters

Note: Estimates from random coefficients logit demand system. The coefficient on characteristic k for consumer i is $\beta_k + \Pi_k d_i + \Sigma_k v_i$, where d_i is a vector of demographics and v_i is unobserved heterogeneity. The specification labeled Demographics sets $\Sigma = 0$ so that heterogeneity only comes from demographic variation. The specification labeled Full allows Σ to be nonzero.

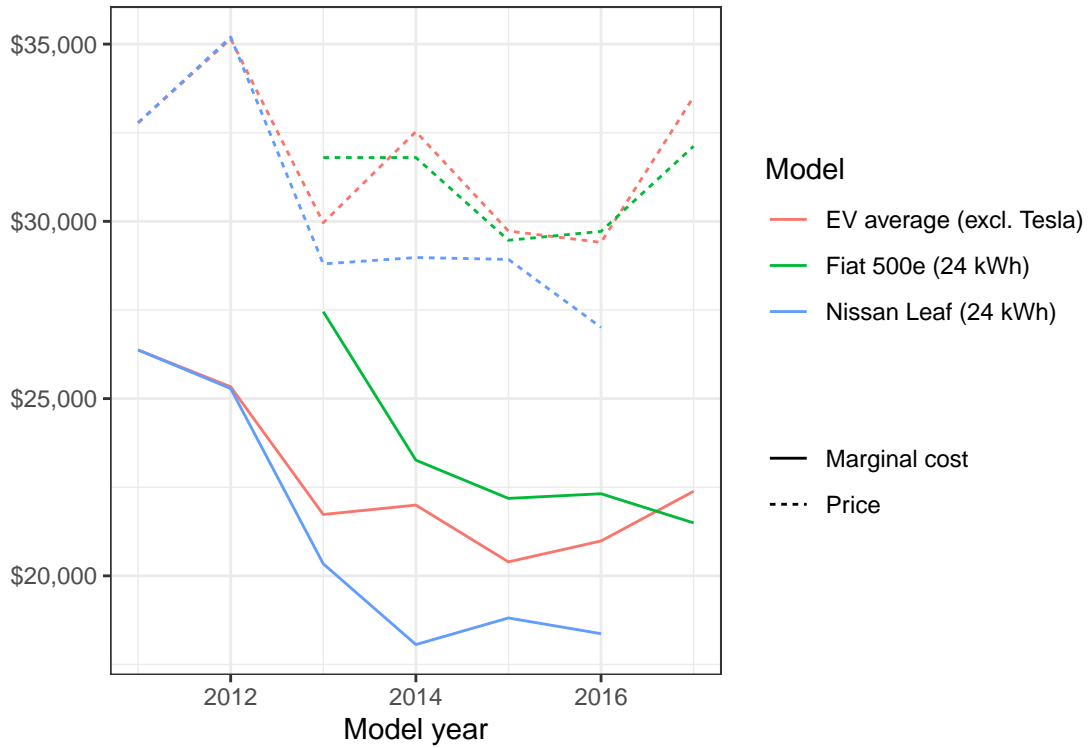


Figure 3: Prices and estimated marginal costs, selected EVs

Note: Prices are MSRP after average manufacturer rebate (from MSN Autos and Automotive News). Marginal costs are estimated from our demand system and national Nash–Bertrand pricing. EV average is sales-weighted.

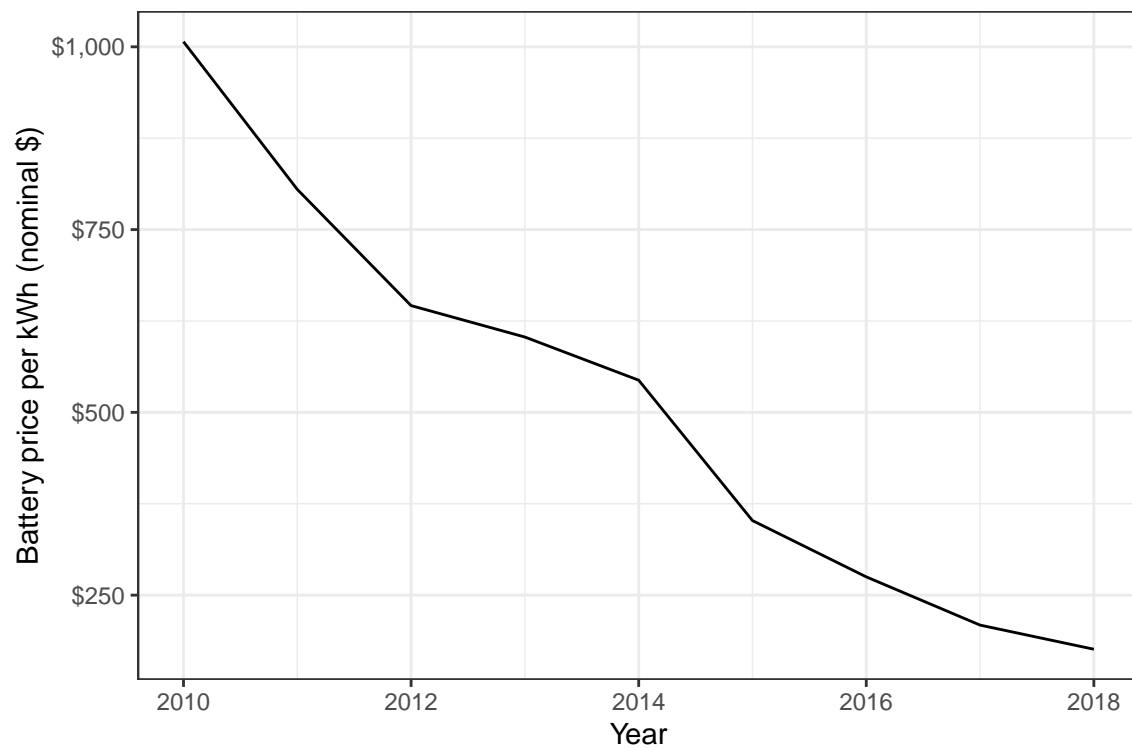


Figure 4: Lithium-ion battery pack prices, 2010–18, from BloombergNEF surveys of the EV industry

Note: Volume-weighted averages from “A Behind the Scenes Take on Lithium-ion Battery Prices” (Logan Goldie-Scot, BloombergNEF, 3/5/19), converted back from 2018 dollars to nominal dollars.

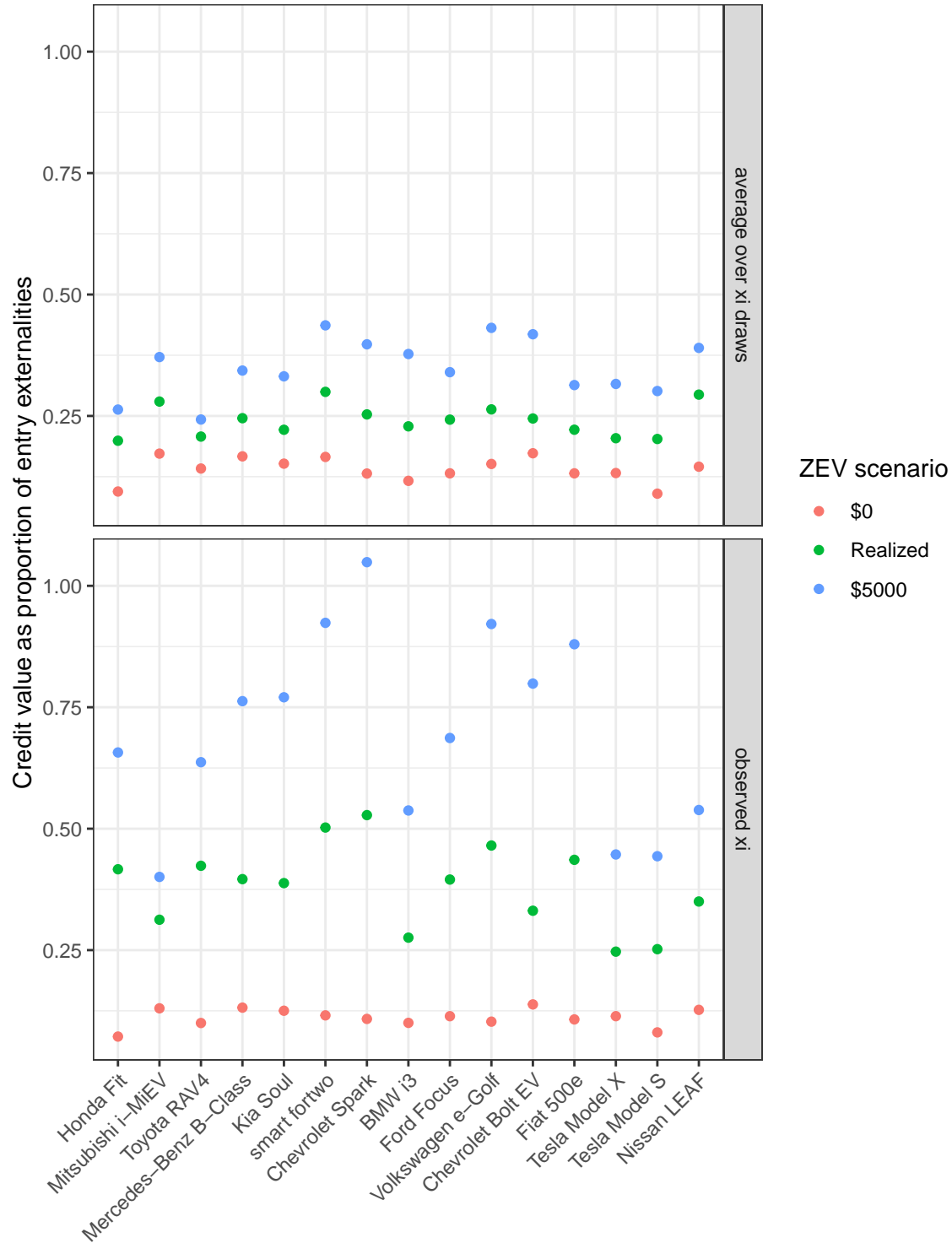


Figure 5: Ratio of credit value to sum of entry externalities, selected EVs

Note: Credit value includes GHG and ZEV credits. Entry externalities are the change in consumer surplus, negative environmental damages, and other-firm profit resulting from entry. Top panel shows averages over draws of product quality; bottom panel shows calculations when product quality is known.

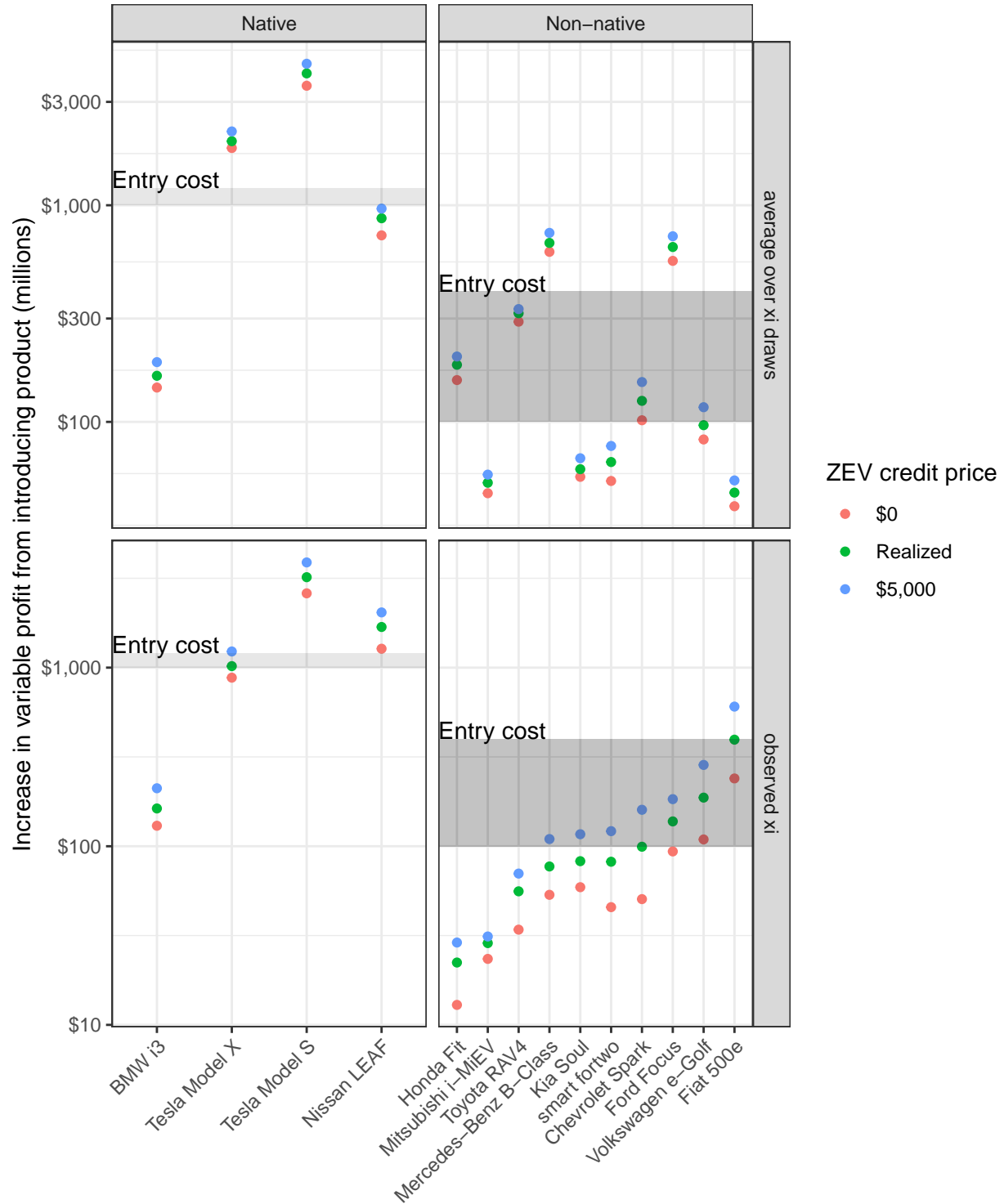


Figure 6: Comparison of incremental firm variable profit with accounting estimates of entry cost

Note: Incremental firm variable profit is the difference between variable profit when the product is in and when it is out, including regulatory credits. It gives an upper bound on entry cost net of unobserved benefit. Entry cost is based on industry accounting estimates. Top panel shows averages over draws of product quality ξ ; bottom panel shows calculations when product quality ξ is known.

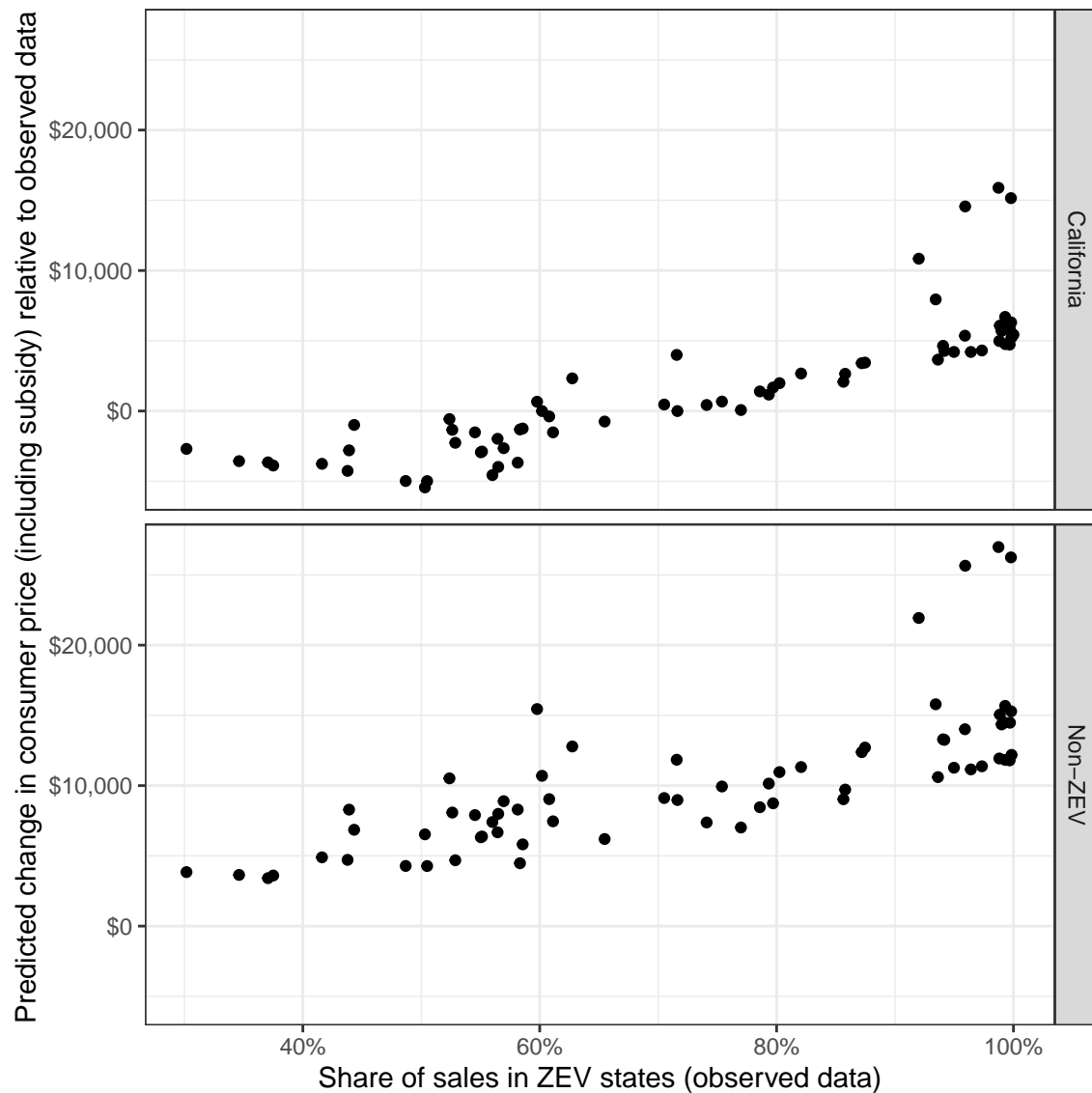


Figure 7: Predicted change in consumer price (including subsidies) for EVs, California and outside regulated states.

Note: For all electric vehicles, this plot shows the predicted change in consumer price (national price minus subsidies) from switching from the ZEV mandate to the counterfactual demand-pull policy, for California and the rest-of-country region only. Products are arranged by the share of their sales that are in the ten regulated states in observed data (under the ZEV mandate). Consumer prices rise for all EVs outside the ten regulated states; consumer prices in California rise for products that are predominantly sold in regulated states, but fall for products that are sold nationally.

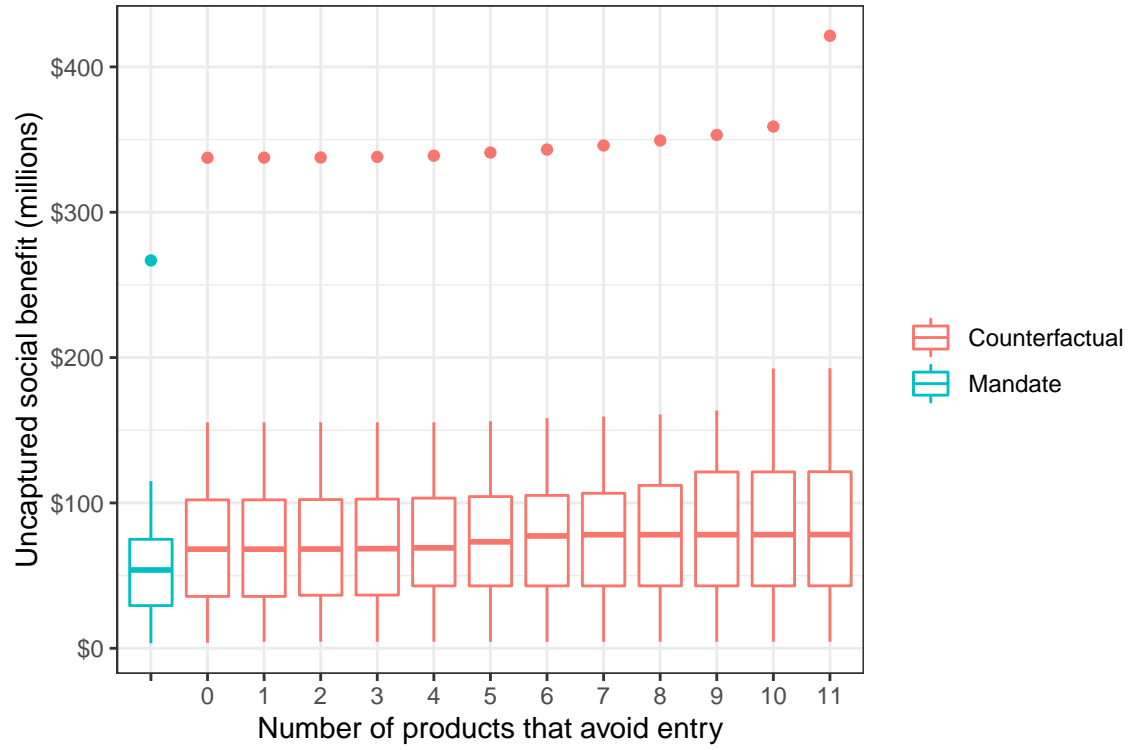


Figure 8: Sum of entry externalities minus credit value, selected EVs, under counterfactual demand-side policy

Note: Credit value consists of GHG credits. Entry externalities are the change in consumer surplus, negative environmental damages, and other-firm profit resulting from entry. All calculations use estimated values of product quality ξ .

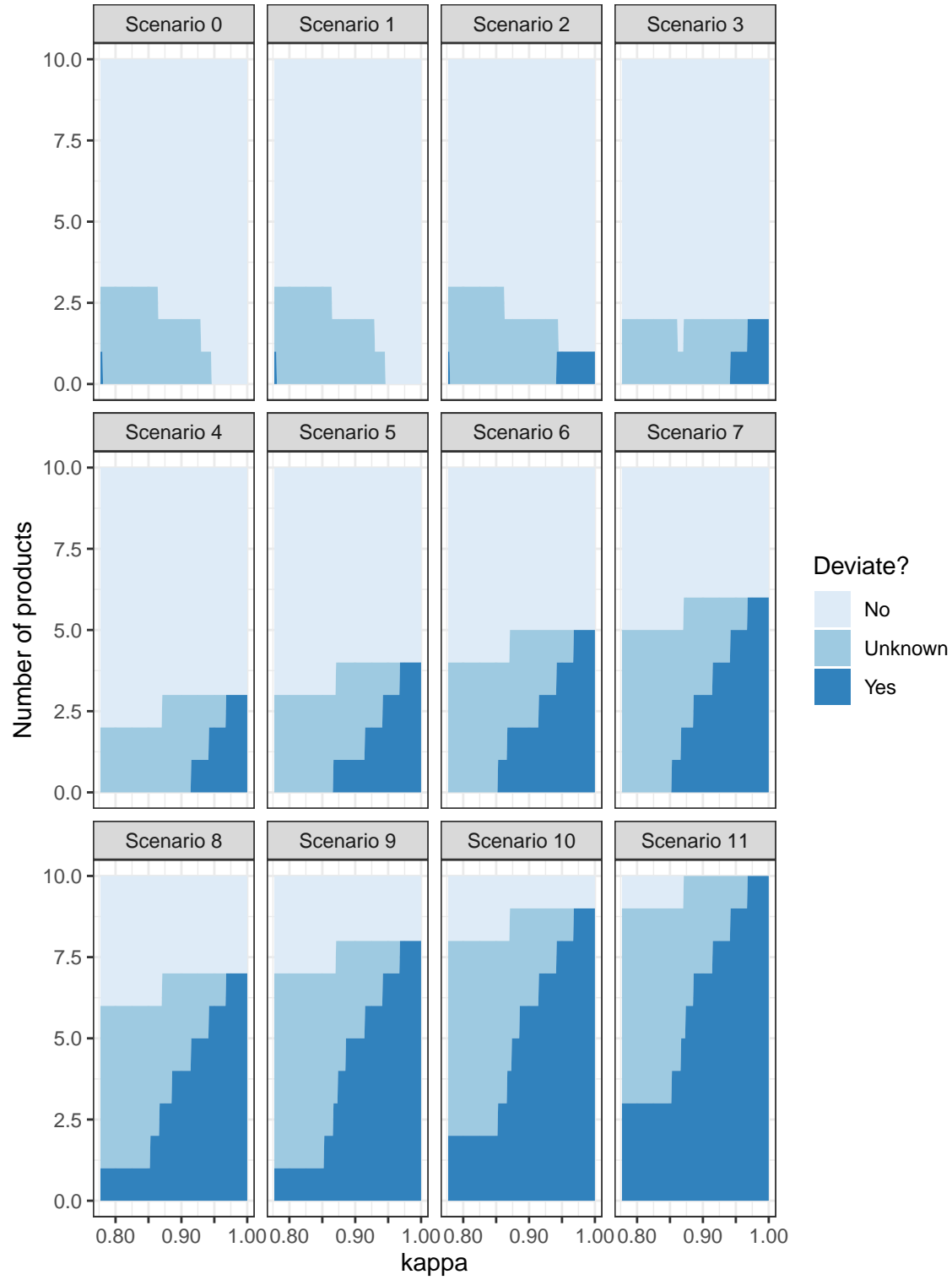


Figure 9: Number of firms with incentives to deviate in each entry scenario, given product entry parameters

Note: Given a value of the ratio of long run benefit to entry cost κ , compute the profit each firm obtains by introducing or removing each non-native electric vehicle, and report whether it is positive. If the sign is ambiguous because of unknown entry cost, report unknown. Scenarios are labeled by the number of models that do not enter.

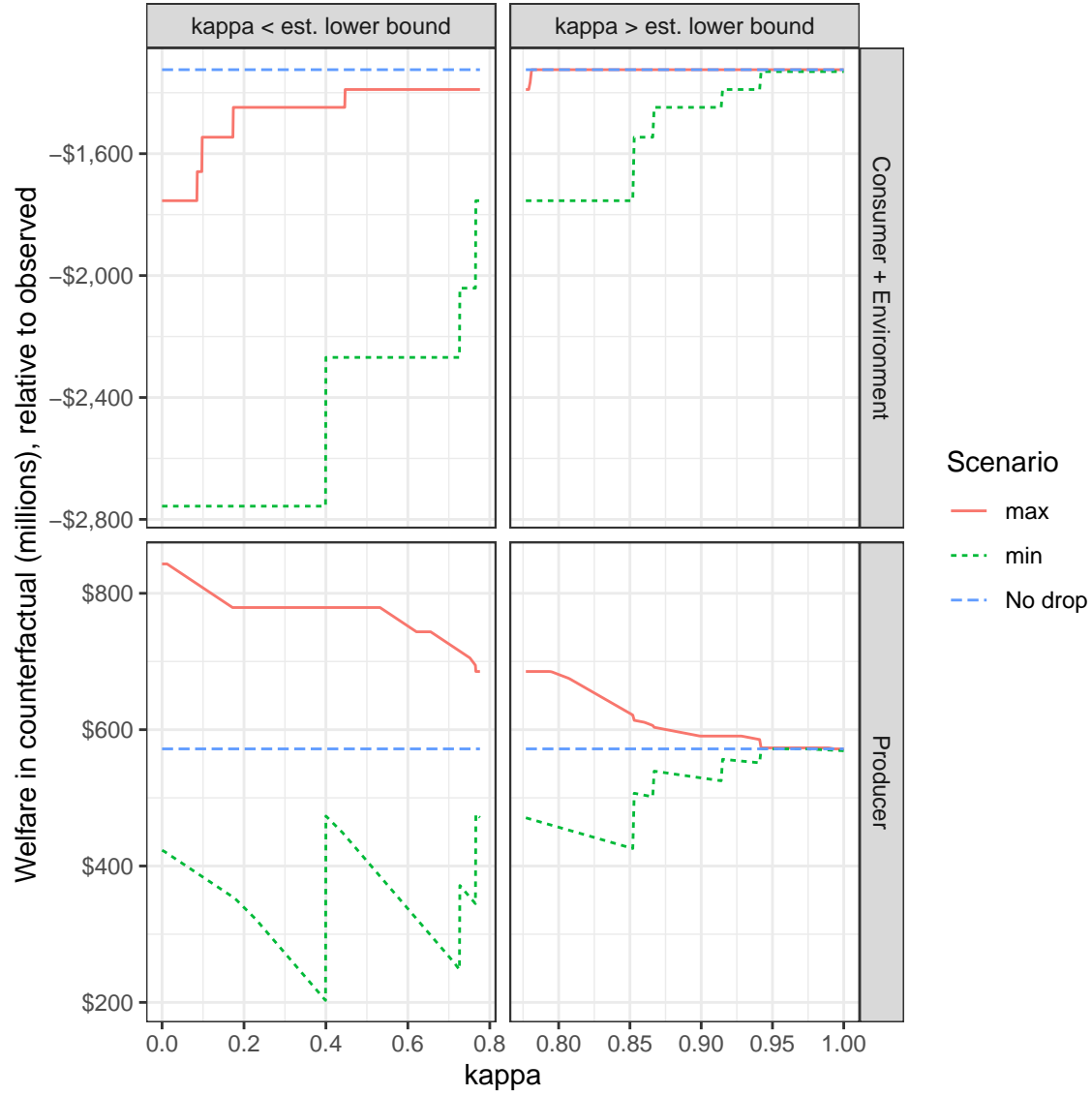


Figure 10: Welfare effect of replacing ZEV mandate with demand-side policy, across entry scenarios

Note: Given a value of the ratio of long run benefit to entry cost κ , compute welfare across scenarios where the n lowest-selling non-native models don't enter. Across the entry scenarios where no firm has an incentive to deviate (or the sign of the incentive to deviate is unknown), take the maximum of the upper bound on welfare and the minimum of the lower bound. Report welfare as a difference from welfare in the observed equilibrium. The scenario where all products stay in is also shown. Results are divided into values of κ rejected by observed entry and values of κ compatible with observed entry.

Model year	Product set unchanged		Product set reduced	
	Subsidy	Tax	Subsidy	Tax
2009	\$0	\$0	\$0	\$0
2010	\$0	\$0	\$0	\$0
2011	\$3,566	\$17	\$3,566	\$17
2012	\$2,616	\$19	\$3,323	\$25
2013	\$3,697	\$83	\$3,850	\$87
2014	\$2,884	\$68	\$3,282	\$78
2015	\$2,356	\$76	\$2,356	\$76
2016	\$2,993	\$126	\$3,002	\$126
2017	\$2,316	\$110	\$2,344	\$112

Table 5: Counterfactual consumer subsidy and tax amounts

Note: This table shows the magnitude of consumer subsidy and tax, within the ten regulated states only, that achieves the same EV sales within the regulated states each year when the ZEV mandate is removed. (Greenhouse gas credits remain with prices unchanged.) The consumer subsidy shown is the amount before range multipliers, and is comparable to the ZEV credit price in Table reftab:credit-prices. The tax per non-EV is set by constraining the subsidy outflows and tax inflows to balance. Firms respond by resetting prices in Nash–Bertrand equilibrium. Run under both the scenario where the product set is unchanged and the scenario where the 4 lowest-selling non-native models drop out.

A Appendix

A.1 Details of the ZEV mandate

As shown in Table 6 (source: 13 CCR §1962.1(d)(5)(A)), the number of credits earned per vehicle was a function of its range. (The regulation used the UDDS urban driving range, which is about 40% higher than the EPA range.) In almost all cases, electric vehicles earned between two and four credits and did not qualify for fast refueling. (An exception is the longer-range versions of the Tesla Model S, which qualified in 2012 and 2013 on the basis of an experimental battery swap program.⁴⁹)

Table 6: ZEV credits, model years 2009–2017

Tier	Criteria		Credits
	UDDS Range (mi)	Fast Refueling	
Type I	[50, 75)	–	2
Type I.5	[75, 100)	–	2.5
Type II	≥ 100	–	3
Type III	≥ 200	–	4
Type III	≥ 100	Yes	4
Type IV	> 200	Yes	5
Type V	≥ 300	Yes	7 (9 after 7/2015)

The credit requirement in each year is formulated as fixed percentage of the manufacturer’s “production volume” of non-zero-emission passenger cars and light-duty trucks. (Before 2009 only light-duty trucks under 3750 pounds loaded weight were counted; between model years 2009 and 2012 this cutoff was raised to 8500 pounds.) The manufacturer chose in each year whether its production volume was its same-year sales or a function of past sales. In model years 2009 through 2011, the past-sales function was the average of sales in model years 2003–2005; in model years 2012 through 2017, the past-sales function in year t was the average of sales in model years $t - 6$ through $t - 4$ (13 CCR §1962.1(b)(1)(B)).

⁴⁹See “Tesla profits could be challenged by Calif. credit-rule change” (Mark Rechtin, Automotive News, 8/5/13).

The credit requirement percentage for applicable manufacturers is shown in Table 7 (source: 13 CCR §1962.1(b)(2)).

Table 7: Large Volume Manufacturer requirements by model year, 2009–2017

Model Years	Minimum ZEV
2009–2011	2.475%
2012–2014	0.790%
2015–2017	3.000%

A.2 National pricing

The key driver of the differences between the ZEV mandate and our counterfactual policy is the institutional feature of national pricing. Though our setup uses a national posted price that the consumer pays directly to the manufacturer, only Tesla sells vehicles this way. Other manufacturers sell new vehicles through dealerships, which negotiate separately with each consumer. (The structure of the new vehicle market is described in Murry and Schneider (2016).) If price variation is only due to factors unrelated to state-level policy, such as vehicle options and consumer information, then the basic implications of national pricing for policy still hold. The main question, then, is whether the transaction price absorbs cross-state differences in subsidies and mandates.

If manufacturers were to adjust prices across states to reflect policy differences, the most likely mechanism would be through manufacturer incentives to dealers or consumers (the rebates studied by Busse, Silva-Risso, and Zettelmeyer (2006)). We have not found evidence of this for EVs. A 2017 California Air Resources Board (CARB) report (California Air Resources Board 2017) found that manufacturer incentives for EVs in February–August 2016 (as reported by AutoNews) were comparable in Seattle, in a non-ZEV state, to a selection of cities in ZEV states. (Manufacturer incentives for hybrids were somewhat lower in Seattle than in the other cities.)

Turning directly to transaction prices, a 2017 analysis of Kelley Blue Book data by the Energy Information Administration (Bratvold and Cleaver 2017) found that average vehicle sales prices for the 2016 Nissan Leaf SV varied little across metropolitan areas, including between metropolitan areas in ZEV and non-ZEV states.

Though California Air Resources Board (2017) found differences across states in median model sales prices, it did not account for trims. The median price paid for a 2015 Nissan Leaf, across all trims, was \$28,900 in California (DMV data) and \$25,123 in a group of ten non-ZEV states.⁵⁰ The 2015 Nissan Leaf had three trim levels with MSRPs of \$29,010, \$32,100, and \$35,120, respectively (as reported by MSN Autos), so it is possible that California buyers paid more because they opted for higher trim levels. (For this model, median transaction prices were clearly well below MSRP.)

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⁵⁰CARB obtained this number from Experian Automotive data from Colorado, Kentucky, North Carolina, North Dakota, New Mexico, Ohio, Oklahoma, Texas, Virginia, and West Virginia.

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