Consumer Federation of America

BRINGING NEW AUTO SALES AND SERVICE INTO THE 21ST CENTURY:

ELIMINATING EXCLUSIVE TERRITORIES AND RESTRAINTS ON TRADE WILL FREE CONSUMERS AND COMPETITION

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I. INTRODUCTION

A year ago the Consumer Federation of America (CFA) published an economic analysis of the impact of restrictive automobile dealer laws on consumers and released the results of a national public opinion poll about these anticompetitive practice. [1] We concluded that exclusive territories, bans on Internet sales, and restrictions on provision of warranty service harm consumers. They

- drive up dealer margins and prevent the distribution of new automobiles from becoming more efficient, resulting in significant inconvenience and increased cost for consumers.

- We estimated that reform of these practices could result in cost savings in the near term of at least $1500 per vehicle, totaling $20 billion or more on an annual basis.

The CFA report called for the elimination of certain key restrictions on the sale of automobiles to expand consumer choice.[2] Public opinion supported these conclusions and still does.

Last month the European Commission proposed a sweeping reform of new car sales and service throughout the European Union that parallels the CFA recommendations.[3] Consumer advocates across the Atlantic have cheered the proposal loudly.[4]

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[1] Mark Cooper, A Roadblock on the Information Superhighway: Anticompetitive Restrictions on Automotive Markets (Washington, D.C.: Consumer Federation of America, February 2001).

[2] Our original report identified about one dozen studies including econometric analyses -- Brown, G. M., "State Motor Vehicle Franchise Legislation: A Survey and Due Process Challenge to Board Composition," *Vanderbilt Law Review*, 1980; Smith, "Franchise Regulation: An Economic Analysis of State Restrictions on Automobile Distribution," *Journal of Law and Economics*, 1982; Eckard, E.W. Jr., "The Effects of State Automobile Dealer Entry Regulation on New Car Prices," *Economic Inquiry*, 1985. Bureau of Economics, Federal Trade Commission, *The Effect of State Entry Regulation on Retail Automobile Markets*, 1986. – legal regulatory reviews – Ohio Attorney General, *Comments on Ohio S.B. No. 206*, 1979; Legislative Auditor of the State of Hawaii, *Sunset Evaluation Report: Motor Vehicle Industry Licensing*, 1986; Florida Office of the Auditor General, *Performance Audit of the Motor Vehicle Dealer and Manufacturer, Factory Branch, Distributor and Importer Licensing Programs Administered by the Department of Highway Safety and Motor Vehicles*, 1986. Bureaus of Competition, Consumer Protection and Economics, Federal Trade Commission, *Response to Wharton Econometric Forecasting Associates Comments on the Bureau of Economics Study of Relevant Market Area Laws*, in American Bar Association, Section of Antitrust Law, *Franchise Protection: Laws Against Termination and the Establishment of Additional Franchises*, 1990. Comptroller of the Treasury, *Tennessee Motor Vehicle Commission*, 1986. Texas Sunset Advisory Commission, *Texas Motor Vehicle Commission, 1991*. Office of Program Policy Analysis and Government Accountability, *Review of the Automobile Manufacturer Licensing Program*, 1996; Virginia Department of Motor Vehicles and the Virginia Motor Vehicle Dealer Board, *An Analysis of the Economic Implications of Manufacturer Owned Motor Vehicle Dealerships*, 1999. – and cost studies -- Price WaterhouseCooper, *Measuring the Automotive Retail Revolution*, 1999; Mckinsey and Company, *Automotive Retailing*, 1998, The Economist Intelligence Unit, *Global Automotive Retailing*, 1999, and survey research – Yankelovich, 2000; Consumer Federation of America, *Anti-Competitive State Laws Cost New Car Buyers More Than $20 Billion Per Year: Consumers Surveyed Strongly Oppose These Laws*, February 8, 2001.

[3] "Commission Publishes Its Draft of a New Regulation for the Motor Vehicle Sector," March 11, 2002, announcing "Draft Commission Regulation… On the Application of Article 81(3) of the Treaty to Categories of Vertical Agreements and Concerted Practices in the Motor Vehicle Industry," *Official Journal*, C-67, 16 March 2002 (hereafter EU Regulation).

After reviewing analyses and events of the past year,[5] we are more convinced than ever that elimination of the restraints on competition would expand consumer choice and save consumers substantial sums and improve their auto shopping experience without diminishing consumer protection

This report provides an update to the previous analysis. We begin by briefly reviewing the issues confronting policymakers. We then examine the response of the dealers to our earlier analysis[6] and contrast it to several other independent analyses that add to the published body of evidence on this issue.

This analysis shows that the claims of dealers are unfounded and their analyses are misleading. Public opinion clearly rejects their arguments. We conclude that our quantitative analysis was extremely conservative. Except for the auto dealer sponsored "studies" these analyses support our earlier conclusions that consumers stand to gain a lot by reducing or eliminating these restraints on trade.

II. THE ISSUE IN BRIEF

A SYSTEM THAT HAS OUTLIVED ITS USEFULNESS

At the beginning of the last century, when the auto distribution franchise system was first created, it could be argued that a system of exclusive franchises was necessary to launch the automobile industry. Given the antiquated transportation and communications network, local stocks of autos and local information dissemination were critical functions necessary to stimulate and meet demand in a timely manner. Because investment in distribution is local and capital markets were nascent, it was felt that the assets necessary to create a national distribution and service system for automobiles might not be forthcoming without reasonable assurances against cut throat competition. Manufacturers and dealers voluntarily created exclusive arrangements to promote investment and the holding of inventory.

While these economic justifications might have been true for fifty years or so, by the late 1960s market structure and economic conditions had changed. Over the years, the growth of

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[4] "Mixed Reactions to Draft Car Block Exemption Proposals," *European Union*, February 9, 2002; Andrew English, "Motoring - The Road Ahead – Car Supermarkets, but no Supermarket Car," February 9, 2002; The *Daily Telegraph*, February 9, 2002.

[5] Additional studies that have come to our attention, beyond the EU Regulation are its supporting documents, including European Commission, *Report of the Evaluation of Regulation (EC) No. 1475/95 on the Application of Article 85(3) of the Treaty to Certain Categories of Motor Vehicle Distribution and Servicing Agreements* (Brussels, 2000), and U.S. and general industry analyses including additional cost studies – Gary Lapidus, *eAutomotive: Gentlemen Start Your Search Engines* (Goldman Sachs, January 2000), The Economist Intelligence Unit, *Global Automotive Retailing*, 2000; Hans A. von Spakovsky, *Eliminating State Trade Barriers to E-Commerce*, (Georgia , October 2000); Evan Schulz, *Automobile Retail and Production in the Age of E-Commerce*, (Economic Studies Institute, June 2001) – and regulatory reviews – Robert Atkinson, *The Revenge of the Disintermediated* (Washington, D.C.: Progressive Policy Institute, 2001) (hereafter Atkinson), as well as more survey research including – Lademan and Porter, *Customer Preferences for Existing and Potential Sales and Servicing Alternatives in Automobile Distribution*, (European Commission Competition Directorate, December 20, 2001); The Massachusetts Consumers' Coalition and Consumer Federation of America, *Massachusetts Consumers Oppose Laws that Restrict Choice in Buying and Servicing New Cars*, February 27, 2002.

[6] Brian Shaffer, *An Assessment of Franchise Laws and Internet Auto Sales* (NADA Public Affairs, August 2001) (hereafter, NADA Reply).

communications, ease of transportation, and improved quality of automobiles had undermined the economic functions of exclusive franchise dealerships. They had become a substantial drag on the system.

Dealers responded as any vested interest would, when endangered by economic change; they turned to politicians to protect their local monopolies. Between 1969 and 1980, approximately 40 states enacted legislation to protect the exclusive franchises that had lost their economic rationale. The voluntary franchise relationships were turned into mandatory restrictions imposed by state law. Relevant marketing area laws allow dealers to block new seller and repair entrants. Other laws require warranty work to be performed by dealers or restrict competition in the sale of financial instruments. Lately, restrictions on the ability of consumers to purchase cars or obtain information over the Internet have been added.

EXPANDING RESTRICTIONS ON SALES OF NEW AUTOS AND RELATED SERVICES

Table 1 summarizes a recent survey of marketing restrictions in the automobile industry conducted by the Virginia Motor Vehicle Board. The specific restraints that we recommend modifying or eliminating are highlighted in the table.

All jurisdictions license dealers (50) and almost all regulate warranty work (48). Almost all jurisdictions (48) regulate the termination of dealerships. Additional regulation of entry and exit are also pervasive including sale and transfer of dealerships (45) and establishment or relocation of dealerships (41). Restrictions on territory (41) and exclusivity (32) are also popular. Explicit prohibitions on manufacturer owned dealerships (MOD) are also prevalent (31).

Many states also regulate the business relationship between manufacturers and dealers. Regulation of allocation of cars is quite common (42). Regulation of price dscrimination against dealers is found in just under half the jurisdictions (22). Regulations are frequently enforced with arbitration requirements (34) and enhanced damages (38). In a smaller number of cases (about a dozen) regulation applies to management, advertising and other aspects of the operation of the dealership.

Most troubling is a recent trend to extend the restrictions to cover more aspects of entry.[7] This includes issues such as providing consumers with information, sharing leads, and financing of automobiles. Efforts to control transactions include state laws that not only prevent manufacturers from dealing directly with the public, but even have banned third-party consumer information and brokerage services. These new laws also restrict competition for financing of automobiles and prohibit manufacturers from rewarding dealers in the consumer's area who have higher service ratings, lower prices or more sales. By further reducing the incentive for dealerships to compete, these restrictions would inevitably result in higher prices and lower quality service.

Particularly troubling are new efforts to control the flow of leads. Over 50% of consumers start their car shopping by going online to learn about vehicles. These shoppers often give their names and contact information. Dealers are asking the legislature to interfere with the way manufacturers distribute those leads to dealerships. They are not allowed to direct consumers to the nearest dealer, or the best dealer.

[7] Diane Katz and Henry Payne, "Traffic Jam, *Reason*, July 2000.

TABLE 1:
STATE REGULATION OF AUTOMOBILE DISTRIBUTION

PRACTICE	NUMBER OF JURISDICTIONS
<u>GENERAL</u>	
LICENSING	50
WARRANTY WORK	**48**
<u>ENTRY AND EXIT</u>	
FRANCHISE TERMINATION	48
ESTABLISH/REESTABLISH	41
SALE/TRANSFER	45
REPURCHASE	38
SUCCESSION	35
MANUFACTURER DEALERSHIP BAN	31
LOCATION CHANGE	14
<u>TERRITORIAL RESTRICTION</u>	
RELEVANT MARKET AREA	**41**
EXCLUSIVITY	**32**
<u>MANUFACTURER DEALER RELATIONS</u>	
VEHICLE DISTRIBUTION	42
ENHANCED DAMAGES	38
ARBITRATION	34
PRICE DISCRIMINATION	22
CONFIDENTIAL INFORMATION	12
PRESALE DAMAGES	12
<u>DEALER OPERATION</u>	
EXECUTIVE MANAGEMENT	14
ADVERTISING	13

Source: Virginia Department of Motor Vehicles and the Virginia Motor Vehicle Dealer Board, *An Analysis of the Economic Implications of Manufacturer Owned Motor Vehicle Dealerships*, 1999.

In addition to the marketing restrictions identified in Table 1, other regulations also apply to new automobile sales and service. Most notably, lemon laws govern the relationship between manufacturers and consumers. There are often other consumer protection statutes that are applicable to new automobile sales, including complaint handling and provision of information.

THE POTENTIAL IMPACT OF THE INTERNET

The crowning irony of the these campaigns to control the distribution of new autos is that the creation and growth of the Internet in the last two decades has rendered these restrictive practices more anti-consumer than ever. Consumer willingness to use the Internet to gather information and make purchases has been remarkable. Notwithstanding the shake out of the Dot.Coms, e-commerce has continued to grow much faster than the economy.[8]

The prospect of reducing distribution costs by increasing efficiency is evidenced by a variety of observable improvements in the marketing process. These changes include more effective shopping by consumers and better targeting of marketing efforts, personalized design of products, and reduced inventory/holding times for the delivery of goods.

- Higher and higher quality visual and video images that can be tailored and modified during the transaction, promise a quantum leap in the quality of marketing and consumer information gathering.

- Increasing integration of production with consumer preferences identified through on-line transactions can both dramatically reduce marketing and inventory costs and increase customer satisfaction.

- Personalized selling and flexible production can combine with interactive scheduling to reduce the amount of time that goods must be held in storage or spend in transit, sharply reducing delivered costs on big ticket items like automobiles.

The Economist summarized the highly efficient distribution system that could exist some time in the future, although it noted that dealers would resist these developments, as follows:

- Internet-based services provide consumers product information, so that the dealer is no longer even asked for such data.
- The rapid build-to-order system envisioned by the OEMs strip away the need for the dealer to hold as much inventory (reducing its role as a stock-holding point).
- Better car quality cuts away at the dealer's non-warranty repair business, as do independent aftermarket players.
- Used car superstores take the used vehicle business.
- Electronic and other channels permit financing companies to peel away traditional dealer controlled F&I [finance and insurance] revenue.[9]

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[8] Robert Atkinson and Thomas Wilhelm, *The Best States for E-Commerce* (Progressive Policy Institute, Mar 2002, p. 3).

[9] p. 161.

PUBLIC OPINION

The public understands this issue quite clearly. In 2001, respondents to a national survey conducted by Opinion Research International for CFA strongly opposed restrictions on new car sales and strongly favor the ability to purchase cars online. – 78 percent said they disagree (59 percent "strongly" so) with "laws that require all car sales to go through car dealerships." Only 19 percent agree with these laws (just 6 percent "strongly" so).

Respondents said these laws "unjustifiably limit consumer choice" (by 58 to 37 percent), "tend to raise car prices" (by 60 to 36 percent), and "limit consumer ability to purchase cars conveniently" (by 64 to 32 percent). Only 43 percent think that these laws would "prevent manufacturers from taking advantage of consumers."

When the use of the Internet is introduced into the consideration, the public opposition to these laws increases. In the national survey, 78 percent think "consumers should have the ability to purchase cars directly from manufacturers or third parties using the Internet (51 percent "strongly" so). Only 16 percent disagree.[10]

These results were replicated in a Massachusetts survey conducted by Acrobat Results Marketing for CFA in 2002. The Massachusetts consumers strongly oppose restrictions on new car sales and strongly favor the ability to purchase cars directly from non-dealers, like manufacturers -- 62 percent said they disagree (33 percent "strongly" so) with "laws that require all car sales to go through car dealerships." 37 percent agree with these laws (11 percent "strongly" so).

Similarly, when the options to purchase cars from these non-dealers using the Internet consumer opposition to laws that restrict their support increases -- 69 percent of Massachusetts consumers said they disagree (59 percent "strongly" so) with "laws that require all car sales to go through car dealerships." Only 32 percent agree with these laws (11 percent "strongly" so).

The national survey also found that consumers strongly support consumer choice of shops to do warranty work. 71 percent think "car owners should be permitted to have manufacturer-paid warranty work performed by independent repair shops" (47 percent "strongly" so); 25 percent disagree.

The Massachusetts survey found even stronger support for consumer choice of shops to do warranty work – 79 percent think "consumers should be permitted to have certified, independent repairs shops" (59 percent "strongly" so); 21 percent disagree (13 percent strongly so). They overwhelmingly oppose laws (73 percent) that restrict their choice of where to have

[10] Not surprisingly, the 59 percent of respondents who say they "have regular access to the Internet for personal use" are the most strongly opposed to restrictions and supportive of consumer choice. Eighty-nine percent of those with access agree that consumers should have the ability to buy cars directly from manufacturers through the Internet while only 64 percent of those without access agree. Also, those who most frequently purchase cars tend to oppose restrictions and support choice. Of the 58 percent of respondents who had purchased a car from a dealer in the past five years, 82 percent agree that consumers should be able to buy cars from manufacturers through the Internet compared to 73 percent of non-buyers who agree.

warranty work done. Interestingly, the survey shows that what consumers really want is choice, since 54 percent say they would still have their work done at the dealership.[11]

TARGETED REFORMS TO STIMULATE COMPETITION AND CHOICE, WHILE PRESERVING CONSUMER PROTECTION

Reflecting the clear conclusion of the economic analysis and the overwhelming public sentiment, our proposals for reform address only the key areas needed to free competition and consumer choice from the grip of anticompetitive restraints. Our proposed reforms would eliminate exclusive territories, authorized non-dealers to be certified to do warranty work, and open up Internet-based information dissemination and sales. All other consumer protections would be kept and extended to brokers or other third parties who sell automobiles in the state.

By removing the most severe restraints on trade that have been imposed over the last four decades, consumers would benefit from increased competition and improved information dissemination, but continue to enjoy fundamental consumer protections. Simply put, the benefits of competition can be achieved without diminishing consumer protections.

Territorial restrictions on sales, bans on manufacturer owned dealerships, restraints on the sale of ancillary services like financing and warranty work, and prohibitions on the dissemination of information should be removed.

Certification and bonding requirements for all parties who sell directly to the public can be implemented for new auto sales, as they are for other products. Dealerships will not disappear, but their roles will change. The most efficient and popular dealerships would expand, and quality repair and maintenance services would be more widely available as service facilities expand.

Lemon laws should not be affected by expansion of authorized service providers, since they have always governed the relationship between the consumer and the auto manufacturer. Warranties are enforceable through any certified dealer. Removing artificial restraints on warranty work should expanded consumer choice and decrease auto costs, which will drive down consumer prices.

Allowing more open entry into the sale of new autos, including direct ownership of dealers by manufacturers, would require provisions to ensure that manufacturers do not unduly discriminate against dealers. In removing the restraints on trade, state laws should ensure that dealers have a private right of action to pursue claims of discrimination under contract law.

III. MISLEADING CLAIMS AND IRRELEVANT ARGUMENTS PRESENTED BY THE AUTOMOBILE DEALERS

The National Automobile Dealers Association (NADA) attempts to defend exclusive territories and other restraints on trade by attributing consumer protection benefits to them and

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[11] Massachusetts consumers overwhelmingly oppose laws “that allow car dealers to prevent the establishment of new dealerships or satellite service centers.” – 72 percent (44 percent strongly) opposed such laws, compared to 28 percent who support them (10 percent strongly).

downplaying their cost to consumers.[12] In the process, they apply faulty economic reasoning to pump up the benefits and very bad arithmetic to diminish the burdens.

DEALER ECONOMICS: A FREE LUNCH, NOT A FREE MARKET

The NADA response to a series of recent studies starts with a section that attempts to rebut the criticism of restraints on trade with the claim that "market-oriented' economy is a far more accurate and less ideological description of the American system than 'free-market' economy."

The dealers criticize "ideologically" driven groups like the libertarian CATO Institute[13] and the moderate Progressive Policy Institute.[14] However, the preference for competition among consumers is not based on ideology, but on the experience that where competition is effective it provides consumers substantial benefits. Where competition is not effective, government should intervene to provide consumer protection, but care must be used because substantial costs can result.

The NADA goes on to offer an illogical claim about warranty work. The dealers state – "Warranty work by dealers – Where is the harm to consumers? It's free! They do not pay for repair under warranty."[15]

Consumers know better than that; the cost of warranty work is recovered in the sales price of the automobile. The restrictions on competition for warranty work allow dealers to charge automakers too much, which the manufacturers recover from consumers in the price of the car. Not only do respondents say that they would prefer choice in warranty work when asked, they vote with their feet when they have the chance. The vast majority of consumers choose independent service providers when they are no longer constrained by the warranty restriction. Authorizing independent repair shops to do warranty work would lower the cost, improve the quality and make it more convenient.

SEPARATING CONSUMER PROTECTION FROM DEALER PROTECTION

The NADA makes extremely broad claims to justify the restraints on trade.

> Communities, governments and local businesses have a mutual interest in economic stability, local employment, local tax revenues, the long-term assurance of product maintenance and provisions for product and consumer safety.

The NADA compares their exclusive territories and monopoly on warranty service to a number of different types of health and safety regulations or professions that are licensed.

> similar protections against unrestricted entry are afforded many community-based industries, such as physicians, hairdressers, taxicabs, hospitals and some utilities… This is not unlike protections for other industries such as occupational

[12] NADA Study, pp. 3-4.

[13] Singleton, Solvieg, Will The Net Turn Car Dealers into Dinosaurs? State Limits on Auto Sales Online (Cato Institute, July 25, 2000).

[14] Atkinson.

[15] NADA Study, p. 4.

licensing, patenting and farm subsidies which are deemed to be in the public interest. Moreover, the specific terms of franchise laws are also found in other industries where regulation is deemed critical to state and local well-being, including farm equipment, petroleum refining and alcoholic beverages.

The fundamental mistake here is to confuse licensing and safety regulation with exclusive territories or service monopolies. Many professions are licensed or subject to certification or other safety regulation, but virtually none have exclusive service areas. In the case of automobile dealers, neither the territorial exclusion nor the requirement that warranty work be provided by dealers is necessary for the purpose of licensing or certification to provide consumer protection. Sellers of automobiles and providers of warranty repair service can be licensed just like physicians are, without assigning them an exclusive territory. Continued certification and licensing without exclusive territories or dealer monopolies on warranty work would protect consumers at a much lower cost.

In fact, as a legal matter, the warranty obligations exist between the manufacturer and the consumer, not the dealer and the consumer. The dealer is only an agent, one among many potential qualified agents. The flaw in the dealer's argument becomes even more apparent when they claim that "from the manufacturer's perspective, it seems doubtful that they would want anyone but an authorized repair shop to identify or bill for needed repairs for which it must pay."

The other public interest benefits that the NADA claims for exclusive territories and restraints on trade in warranty service are even more of a stretch. States collect sales taxes on automobiles when they are registered, they do not need exclusive sales territories to do so. To the extent that the price of autos declines because of more competition, there would be a reduction of tax collection, but in most jurisdictions 95 cents of every dollar saved would end up it the consumer's pocket, even if the tax revenue had to be replaced. With respect to employment and payroll or property taxes, sound economic analysis indicates that these factors of production would be employed in their next best uses.

DEALER MATH: 3 + 3 + 3 = 2

Having misstated the benefits of these anticompetitive policies, the dealers set about underestimating the costs that the restraints on trade impose on consumers. The primary response of the dealers here is to claim that there is simply no margin to be squeezed out. They present a chart that shows average dealer mark-ups of about 8.6 percent per vehicle, or just over $2235 per auto. This cost is estimated as the difference between the dealer invoice plus destination charges and the retail price.

Since CFA projected savings at $1500 per car, the implication is that the industry could not possible sustain such resource cuts. The NADA gets the math wrong in three areas.

The dealer margins are larger than their analysis claims as are the potential savings. The analysis ignores the fact that dealers get discounts off of the dealer invoice, which puts more money in their pockets. These dealer discounts are quite substantial. They may run as high as another $1000 per car. In other words there is, in fact,[16] over $3200 per car of costs that can and should be subject to competitive pressures.

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[16] Chris Knap, "Fees and Conditions There's More to a Car Price Than 'Dealer Invoice'," *Chicago Tribune,* February 5, 2001.

The NADA vastly underestimates the extent to which dealer margins can be reduced. CFA identified four published studies that directly estimate the costs of exclusive territories. The NADA report selectively and incorrectly reports the results, ignoring the explicit finding of the authors. Not one of the numbers the NADA attributes to the studies appears on the cited pages or the documents. The NADA apparently misstates the results by dividing the authors findings by national sales totals, instead of the number of units sold in the states that the authors studied.[17]

For example Richard Smith, *Franchise Regulation: An Economic Analysis of State Restrictions on Automobile Distribution*, found that "The average price increase across states due to REGS… is $524 (1972 dollars) or 9.3 percent of the average observed price."[18] NADA claimed that the study showed the impact of exclusive territories that are half that large – 4.7 percent or $265 per car.[19]

Similarly, Robert P. Rogers, *The Effect of State Entry Regulation on Retail Automobile Markets*, found the impact of exclusive territories "with an average across all models of 6.14 percent."[20] Yet NADA claimed that the impact was only "1.7%."[21]

Finally, Eckard, E.W. Jr., *The Effects of State Automobile Dealer Entry Regulation on New Car Prices*, reported "the average (sales weighted) effect for urban dealers is about $56.3, almost exactly twice the $27.8 effect for rural dealers,"[22] measured in constant 1972 dollars. Yet, NADA reported the impact as much smaller, only $7.25

The dealers complain that the data relied upon in these studies are old, asking "why doesn't anyone come up with more recent data or statistically valid studies that account for contemporary market conditions?"[23] The answer is straightforward. These studies were conducted at the last moment when there was a sufficient mix of restricted and unrestricted states. In 1978, 22 states had the restrictions. By 1983, 36 did. Today the figure is 41, and the states without restraints tend to be small and unrepresentative of the rest of the nation. Because the practice is pervasive, there is not enough variation to do statistical studies. Looking at what happened before the practice became pervasive, considering close analogies, and reviewing direct cost estimates provides a sound basis for public policy.

GAINS FROM EFFICIENCY IN DISTRIBUTION AND COMPETITION FOR ANCILLARY SERVICES

A second source of cost savings for consumers would be to squeeze out the inefficiencies of distribution and production of automobiles. Exclusive territories protect the brick and mortar costs of dealers from competition. Potential savings in the distribution of autos would flow from the ability to build cars to order and deliver them in a much more timely fashion. The dealer distribution system stands between consumers and manufacturers. Dealers thrive on

[17] In the case of the Smith study, the NADA analysis excludes a cost to consumers that Smith called "price packing," which he considered a "resources loss attributed to regulation."

[18] *Journal of Law and Economics*, 1982, p. 150

[19] NADA Study, p. 3.

[20] Bureau of Economics, Federal Trade Commission, 1986, p. 107.

[21] NADA Study, p. 4

[22] *Economic Inquiry*, 1985, p. 239.

[23] NADA Study, p. 4.

inventory, having lots of models to show to consumers and pushing consumers towards models with more options and higher margins.

Some of these costs could be saved by the manufacturer. For example, efficient production eliminates inventory, allows manufacturers to build-to-order and deliver just-in-time. The analysis should include the dealer destination charges that could be reduced in a rationalized distribution system. This amounts to an additional $550 of costs that would be the target of reduction.

Dealer costs are also substantial. Inventory, selling and advertising costs are in the range of $1000 to $1,500 per car.

The Economic Strategy Institute (ESI) has recently re-examined the Goldman Sachs estimate of efficiency gains. ESI concluded that substantial savings are possible. It placed "savings from an advanced automobile e-commerce systems organized around a built-to-order system,"[24] at over $2500 per vehicle.

These savings do not include substantial cost savings that consumers could reap as a result of introducing competition in warranty, after-market service, and financing. In addition to increasing the price of the auto, in recent years dealers have also begun to leverage their market power into after-market and ancillary services.

Restrictive laws have been extended to block out competition for financing, extended service and parts. These impose additional costs on consumers that are new since the earlier studies were performed. The stakes are large here as well. The cost of service at dealerships is substantially higher than at independent outlets; 30 percent more than even the major chains.[25] Goldman Sachs estimates $450 per auto on warranty work or about $8 billion per year. "Dealers own the warranty business since they're the only ones certified by factories to provide it."[26] Competition could save consumers billions more in this area alone.

Insurance and finance charges are another area in which dealers are pressing efforts to restrict competition. EU analysis of regulatory reform points out that the amount consumers spend on finance and insurance over the life of the car is equal to half the original purchase price of the car. The analysis of early Internet shopping indicates the potential for hundreds of dollars of savings in this area as well.[27]

THE BOTTOM LINE: HUGE CONSUMER SAVINGS FROM ELIMINATING RESTRICTIONS ON NEW AUTO SALES AND SERVICE

Thus, for automobiles costing about $25,000 the total base of distribution and warranty costs against which reform would be working is approximately $6,000 per car. CFA's estimate of savings of $1500 per car is quite conservative. Goldman Sachs estimated "$2,100 per vehicle is hard-dollar cost reduction, which will presumably flow back to the consumer in the form of lower prices."[28] Our initial analysis demonstrated that interbrand competition would drive the pass through to consumers.

[24] ESI, p. 24.
[25] Earle Eldridge, "When Autos Need Repair, Where?", *USA Today*, August 29, 2001.
[26] Lapidus, p. 45.
[27] Morton, et. al.
[28] Lapidus, p. 6.

Our analysis focused on online sales and make-to-order efficiencies. In other words, we are projecting cost savings in the range of 25 to 35 percent of the distribution costs. Cost savings in intermediate distribution services in industries that have not been characterized by state imposed restraints of trade have been projected at this rate or higher.[29] Thus, we were being conservative in our estimates.

At current levels of sales, the savings would exceed $20 billion per year. Potential savings on after-market sales and service would increase that figure substantially. The reforms necessary to begin the process of rationalizing new auto sales and service can be narrowly targeted on the three or four specific practices that deny consumer choice and diminish competition. The specific proposals laid on the table by the EU are an example that American policy makers should follow.

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[29] CFA, Roadblock,