APPENDIX 9.2
(referred to in paragraphs 9.40 and 13.40)

Studies on the effects of VERs

A. Study by the Organisation for Economic Co-operation and Development (OECD) 1987

1. The OECD considered the effects of VERs in four countries: the United Kingdom, the United States, Canada and France.

United Kingdom

2. First in respect of price effects the OECD study found that VER protection had led to an increase in car prices but that other factors (including higher cost domestic production, increasing specification levels and the major role of fleet sales) had also contributed to the high level of prices in the United Kingdom market. During the years 1979 to 1982, the study concluded, Japanese car prices could have been of the order of 10 per cent higher because of the VER. Without such protection, the additional price competition that would have resulted would have put pressure on other manufacturers, both domestic and foreign, to lower their prices.

3. The OECD study found that in terms of sterling the unit value of Japanese imported cars increased between 1975 and 1985 by more than both the PPI for cars or the RPI for all motor vehicles. However, over most of the period, the increase in Japanese unit values (or average prices) was in fact less than that for West European car importers. Moreover, after adjusting for exchange rate changes, Japanese prices also rose less rapidly than both the price of domestically-produced cars and the price of all cars sold in the United Kingdom.

4. The OECD study considered various factors that might have led to the observed increase in the price of imported Japanese cars over this period. An increase in model size and specification level, for example, is one possibility. Unlike the study on the United States market the evidence suggested only a modest tendency in that direction by Japanese suppliers in the United Kingdom, though the study did not attempt to examine specification levels in detail. On model size, the study found that there was a small increase in the product mix toward larger models in the early years of the VER, but that after 1979 there was no significant change in the Japanese sales mix while the overall market in fact shifted in favour of smaller cars.

5. On specification levels the study noted that even prior to the introduction of the VER Japanese importers had generally provided a high level of specification at any given price level, partly for competitive reasons and partly because of the practical difficulties of offering many different variants over a large shipping distance. There was less scope than in the United States market for Japanese importers to substantially upgrade their level of specification following the introduction of the VER in the United Kingdom. The study noted that Japanese cars were still amongst the lowest priced cars in each market segment after adjusting for specification level. Indeed, a large part of the increase in Japanese prices appeared to reflect increases in product quality and increases in input costs, though the latter did not take full account of the significant gains in labour productivity achieved by the Japanese during the 1970s.

6. The importance of fleet sales in the United Kingdom was also considered to be a relevant factor. The study argued that because of the high level of discounts that are common on fleet sales, which were dominated by United Kingdom domestic suppliers, the price level in the private sector of the market has been higher than it would have been otherwise. Since the Japanese had not until recently been able to make many fleet sales, they were competing in the higher-priced part of the market. Because the price level was in any event generally high in the United Kingdom private sector of the market, the Japanese suppliers might have had limited scope for further increases in price at the time the VER was introduced, according to the OECD study.

7. Two other aspects of the scope for Japanese price increases were considered in the OECD study. First, it noted that imports into the United Kingdom from West Germany increased steadily almost throughout the period 1975 to 1985, despite the increase in the average price of these imports over and above exchange rate effects. The strength of demand for high-quality West German cars, as well as the increasing availability of other imports, may have tempered the ability of the Japanese suppliers to raise their prices. Secondly, the study looked at whether the Japanese had managed, within the VER limit on overall market share, to achieve a dominant position in any particular market segment that they might have been able to exploit in terms of raising prices. In the United States market, for example, the Japanese dominated the small segment with a market share of over 90 per cent. In the United Kingdom, however, this did not appear to be the case: the Japanese faced strong competition from European producers in all segments.

8. The OECD study concluded that, because of these various constraints on them, the scope for the Japanese to raise their prices in the United Kingdom as a direct result of the VER was more limited than had been the case in the United States. Nonetheless, it found that the Japanese were able to raise their prices in line with the price increases of domestically-produced cars and other imports; and that Japanese prices were probably some 10 per cent higher because of the VER in the years up to 1982. After that, the evidence of price discounting by the Japanese in subsequent years suggests that the effect of the VER may have become of lesser importance, particularly for Nissan. The study noted also that the overall level of United Kingdom car prices had declined in real terms after 1980 and that the price gap between the United Kingdom and the rest of Europe appeared to be narrowing.

9. Following on from the price analysis the study concluded that without the VER the Japanese might have taken up to 20 per cent of the United Kingdom market by 1980, an increase in sales of 123,000 cars over the 180,000 actually sold in that year. With the VER, however, the study found that only around 50,000 additional cars were built in the United Kingdom, the balance coming from imports from other European countries, particularly West Germany. In consequence, the employment impacts on domestic producers (of both cars and components) were estimated to be rather modest, the increase in jobs being between 2,000 and around 7,000. This was considered to be small when compared with the loss of 180,000 jobs after 1979 that was necessary to restore the competitive position of the United Kingdom car industry. These estimates do not, however, take into account impact on employment arising from inward investment by Nissan and other Japanese suppliers.

10. On investment, the OECD study concluded that the significant new investment which had been undertaken by BL and Ford in the early 1980s might in part have been encouraged by the VER. This investment was necessary if the competitiveness of the United Kingdom industry was to be restored and its survival ensured. The study further concluded that the process of adjustment and rationalisation within the industry had probably been delayed by up to two years because of the VER. Similarly, the VER had only led to direct investment by the Japanese suppliers as much as a decade after it had been introduced and the existence of the VER was not the only reason why they invested in the United Kingdom. More important were the relatively low wage rates available and the fact that the United Kingdom economy was more open to foreign investment than other EC countries such as France or Italy. The United Kingdom was seen by the Japanese therefore as a suitable base from which to supply other EC markets that are protected by VERs.

11. As regards the impact on market structure and competition, the study concluded that the VER was pro-competitive to the extent that it enabled BL (and its successors) to survive an especially difficult period. However, despite benefiting from trade protection, it was less and less able to provide a competitive challenge to the market leader, Ford, particularly in fleet sales. Moreover, the VER clearly inhibited competition between the different Japanese suppliers, since their relative market shares were essentially frozen at the time the VER was introduced. This had the further effect of limiting their ability to compete effectively in fleet sales, because they were not able to establish a broadly-based distribution network.

United States, Canada and France

12. The effect of VERs on prices appears from these studies to have been greater in the United States and Canada than in France (and also in the United Kingdom). In the United States, price increases were the highest, in part reflecting the apparent absence of alternative low-cost imports to the Japanese. The study estimated that the existence of the United States VER had led to an increase in Japanese car prices of between 15 and 25 per cent when Japanese imports were limited to 2 million units and by between 10 and 15 per cent when the limit was adjusted upward to 2.3 million units. At the 2 million unit level, the increase in costs to consumers because of the VER was estimated to have been between $3.25 and $5 billion per year (ie between around $1,600 and $2,500 per car imported from Japan). The study further suggested that United States domestic producers were also able to raise their prices because of the protection from import competition.

13. Car prices in Canada were also found to have increased substantially because of VER protection, but by less than in the United States because of the availability of substitute imports in that market. The Canadian study concluded that the introduction of low-priced Korean vehicles, produced by Hyundai, had tempered the ability of both the Japanese and domestic suppliers to raise their prices. The effect of the VER was estimated to have raised Japanese prices by around 7.5 per cent or C$900 per car, but without Hyundai average prices might have been increased by an extra C$800 per car.

14. In France, price effects were also apparent, but the increase in price was estimated to have been rather modest (at least compared with the effects in other countries) at around 7 to 9 per cent between 1980 (when VER protection was first introduced) and 1983. As in the Canadian market, the ready availability of substitute imports, mostly from other EC suppliers in the case of France, was concluded to have moderated price increases by Japanese suppliers. Additionally, the appreciation of the yen against the franc was of a similar magnitude to the observed price increases. Against that, however, the exchange rate-adjusted comparisons of price broadly assume that production costs remained constant and do not allow for the potential reduction in Japanese prices that might have resulted from the considerable gains in labour productivity achieved by Japanese suppliers over that period.

15. On trade effects, the studies found that for all three countries the existence of VER protection had tended to attract imports from other sources that were not subject to trade restrictions. This import substitution effect was most pronounced in Canada where Korean imports (from Hyundai) had mitigated the anti-competitive effects of the VER.

16. VERs were found to have encouraged inward investment by the Japanese in the United States, but not to any significant extent in either Canada or France. In the United States, direct investment of over $2 billion had been made by five major Japanese manufacturers as a result of the VER, according to the study.

17. As regards employment effects of VERs, the studies found that the number of jobs saved in domestic production had been rather modest. In the United States, of the order of 20,000 to 35,000 jobs had been preserved because of the VER protection, but this was relatively small compared, for example, with the 200,000 jobs lost because of lay-offs in the domestic industry in 1982. The study estimated that the cost to consumers through higher prices was equivalent to $93,000 to $250,000 per job. The employment gains from VERs were similarly modest in Canada. In France the impact appears to have been negligible. Indeed there was a net loss of employment in car production in France in the period studied, mainly because of lower French exports and the growth of imports from other EC countries.

18. VERs were also found to have influenced competition and market structure within the domestic markets studied. In the United States, for example, the VER was found to have increased the market power of the domestic manufacturers, which reduced the incentives to restrain price increases and to produce the types of cars most wanted by consumers. Moreover, the method by which the VER was administered tended to further reduce competition, by eliminating competition between Japanese firms for market share within the overall VER limit. Similar effects were found to apply in Canada and France, though to a lesser extent because of the greater level of import substitution.

B. Cardiff Business School (CBS) study, by Professor Garel Rhys and Dr John Bridge, 1989

19. This CBS study, which was commissioned by the NCC and published in July 1990, looked at various aspects of the EC car market, including possible barriers to trade and competition, the BEUC survey of price differentials between different EC countries and the economic costs to EC consumers arising form VERs applied to Japanese car imports. The study also provides a bibliography of other studies on VERs.

20. Using the economic analysis of VERs outlined at Appendix 9.1, the CBS study considered the possible market effects of VERs and under what conditions EC consumers would pay higher prices and face reduced choice as a result of a EC-wide VER on Japanese car imports. In quantifying the economic costs to EC consumers, imports from Japan were assumed to be low cost and highly competitive, so that they effectively set a `world price' for the car market which is lower than would arise with a VER or were the EC market to be supplied entirely by higher-cost European producers.

21. The CBS study cautioned that the figures used were illustrative and that the simplified analysis employed depended crucially on a number of assumptions. Quantifying the responsiveness of demand to changes in the price of Japanese cars was considered to be a particularly difficult area. The study took the elasticity for Japanese imports to be about 4, which, the study suggested, was reasonably consistent with other comparable studies such as those undertaken by the OECD. Japanese car prices in the EC market were thought to be some 20 per cent higher than they would be without a VER. Applying these broad assumptions to the EC market in 1989, the study suggested that the level of Japanese imports might plausibly have been around 80 per cent higher without a VER, implying an increase in demand from 1.1 million to 2.0 million units. The study then calculated the losses to consumers on the basis of a `typical' mid-sized car (equivalent to a Toyota Corolla) with a list price of £6,500 at 1989 prices. After making price adjustments for customer discounts (5 per cent off list price) and netting off part of the dealer margin and import duty, the study estimated the additional cost per Japanese car to have been just over £1,000 in 1989. For EC consumers as a whole, the total costs over a full year were estimated to have been about £1.6 billion.