# 9 Voluntary export restraints

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## Introduction

9.1. In earlier chapters we have considered a number of aspects of the new car market: the structure in Chapter 4, the distribution system in Chapter 5 and prices in Chapter 7. We now consider the major constraint on competition in the United Kingdom market, namely the VERs that apply to Japanese exports.

9.2. The Japanese car industry has been the subject of VERs for many years. They have applied at various times to exports to a number of countries of the EC, to the United States, and to Canada. VERs have been the subject of considerable controversy and have at times played an important role in the trading relationships of Japan and the importing countries. The EC Commission has recently reached a `consensus' with the Japanese Government on the phasing out of VERs on cars in the EC (as described in paragraphs 9.56 to 9.66). VERs are quite separate and different from tariffs. The EC operates an external tariff of 10 per cent which applies to Japanese imports, and this is unaffected by the `consensus' with the Japanese on VERs.

9.3. A VER is an informal national restriction on trade under which manufacturers in one country limit their exports of specified products to another country. The form of the VER may be a volume limit, a maximum market share or a less precise form of restraint. A VER may be operable for a particular period of time or the duration may be unspecified. Although VERs are by definition a restriction on international trade, they have been argued not to infringe the rules of the General Agreement on Tariffs and Trade (GATT) because they are voluntary.

## VERs in the United Kingdom

9.4. Japanese exports of cars to the United Kingdom have been the subject of VERs since the end of 1975.

9.5. In 1971, 12,995 Japanese cars were registered in the United Kingdom (1.0 per cent of the total); and in 1975, 107,934 (9.04 per cent). The SMMT was deeply concerned at this rapid growth, and in May 1975 it asked the Department of Trade to impose an anti-dumping duty of 10 per cent on Japanese cars. The Department did not consider there was sufficient evidence to justify this action but invited the SMMT to discuss the possibility of VERs with JAMA. Accordingly the SMMT's President (the then Chairman of Ford) broached the issue with the President of JAMA in Tokyo in July 1975, but this met with a negative response.

9.6. In September 1975 the then Secretary of State for Trade, the Rt Hon Peter Shore MP, visited Japan and had talks with the Japanese Government and JAMA. On his return, in response to a Parliamentary Question, Mr Shore said:

> I indicated both to the Japanese Government and to their industry that in the British Government's view the rapid build up this year in Japanese car exports to the United Kingdom was unacceptable. For their part, the Japanese Government predicted that during the remainder of this year their exports of cars to the United Kingdom would decline, and acknowledged that Japanese cars should be exported to the United Kingdom in an orderly way during 1976. I shall continue to keep a careful watch on the situation.

The DTI told us that it considered that this statement effectively marked the commencement of the VER for vehicles (`vehicles' because it applied not only to cars but also, from 1978, to light commercial vehicles).

9.7. In December 1975 a JAMA Presidential delegation visited London for further talks with the SMMT. The SMMT's minutes record that at the conclusion of the meeting JAMA said that it:

> recognised the seriousness of the problems facing the British motor industry and forecast that over the first three or four months of 1976 Japanese manufacturers would maintain their penetration at about the level of the latter part of 1975. Beyond that period Japanese penetrations would take into account the position of the British economy. With regard to the differences in view between the Society and JAMA on the level of demand for 1976, JAMA would give the general assurance that if demand were to fall then Japanese sales could also be expected to fall.

JAMA told us that at the conclusion of the meeting it had `expressed genuine understanding with respect to the United Kingdom market situation'.

9.8. The next meeting was held in Tokyo in July 1976. Again the SMMT team was led by its President (on this occasion the then Managing Director of Rolls Royce). After detailed discussion of the performance and prospects of the United Kingdom new car market JAMA concluded by saying:

> In discussing the outlook for Japanese sales in the United Kingdom market for 1976, JAMA would be referring to:
>
> (i) economic trends in the United Kingdom and in Japan;
>
> (ii) the level of inflation in the United Kingdom and in Japan both with regard to raw material prices and retail prices;
>
> (iii) the future relationship between the pound and the yen; and
>
> (iv) the question of exports of cars from other countries to the United Kingdom during 1976.
>
> These factors would need to be taken into account to form a judgement. It would not be necessary to discuss precise figures in any way. JAMA would be referring to import penetrations and they could say now that the Japanese share of the British market in 1976 would not exceed the 1975 level.

9.9. There have been one or more similar meetings between JAMA and the SMMT in every year since then. We have seen the SMMT's minutes of several of these meetings, and the extensive briefing papers prepared by the SMMT in anticipation of them. It appears that on each occasion the Presidential meeting has been preceded by close and detailed discussion by SMMT and JAMA staff of the forecast size of the United Kingdom new car market in the following year. At the Presidential meetings the Japanese import penetration for the year under review has been discussed; the SMMT has sought assurances from JAMA on the level of imports for the following year; and JAMA has affirmed its adherence to a policy of `prudent marketing'. This expression has never been defined but has been taken by the SMMT to mean willingness by JAMA to use its best endeavours to keep Japanese penetration of the United Kingdom market to a reasonably stable and moderate level. Over the years 1976 to 1990 this share has fluctuated between 9.3 and 11.9 per cent, with an average of 10.6 per cent: see Table 9.1. These fluctuations, although small in absolute terms, have been considered by the SMMT to be disturbingly large in relative terms from time to time, eg in 1977 and 1980, and this has led to strong SMMT representations on those occasions.

TABLE 9.1 **Japanese imports: share of the United Kingdom new car market**

*per cent*

| *1976* | *1977* | *1978* | *1979* | *1980* | *1981* | *1982* | *1983* | *1984* | *1985* | *1986* | *1987* | *1988* | *1989* | *1990* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 9.4 | 10.6 | 11.0 | 10.8 | 11.9 | 11.0 | 11.0 | 10.7 | 11.1 | 10.8 | 11.3 | 9.8 | 9.5 | 9.3 | 10.1 |

*Source*: SMMT, and MMC calculations on data supplied by companies.

9.10. Press releases following Presidential meetings speak of the purpose of the discussions between the SMMT and JAMA as being to have an exchange of views on matters of common concern, but the press releases do not identify them. JAMA told us (see paragraphs 12.34.1 to 12.34.4) that:

*(a)* no agreement or arrangement whatever had at any time been made between the members of JAMA and the members of the SMMT through the JAMA/SMMT talks; and

*(b)* no arrangement on the supply of Japanese motor cars into the United Kingdom had been made at any time since the beginning of the talks in 1975.

On the other hand, the SMMT's minutes of Presidential meetings, and the briefing material prepared for them, speak frequently of assurances being sought by the SMMT, and being given by JAMA, on the supply of Japanese cars into the United Kingdom. The SMMT told us that these assurances were given voluntarily and were revocable at any time on the Japanese side. The SMMT, like JAMA, said that the discussions did not lead to an agreement.

9.11. There are also differing views on the means by which JAMA gives effect to VERs so far as its members are concerned, ie whether there is an allocation between Japanese manufacturers of the forecast share of the United Kingdom new car market. The JAMA statement (see paragraph 9.10) necessarily implies that there is no allocation. The Toyota Motor Corporation (TMC) told us that it did not accept that it operated under an allocation regime (see paragraph 12.12.8). But the Board minutes of two United Kingdom companies importing Japanese cars discuss their allocations in detail over several years. The detailed effects that VERs have had on Japanese suppliers to the United Kingdom market were illustrated by minutes of the Board meetings of TGB Holdings Ltd which we inspected. These minutes clearly show the difficulty of suppliers in securing sufficient cars and the distortion of competition between those suppliers as a result of their allocations of United Kingdom market share.

9.12. Against this background we looked at the structure of the SMMT and the extent to which its members are involved in the conduct of its affairs.

9.13. The SMMT is a company limited by guarantee, with a membership which includes virtually all the suppliers of new cars in the United Kingdom (but also includes about 1,300 companies, organisations and individuals not in that category). The SMMT's policy and outside activity is controlled by the Executive Committee, which consists of the SMMT's President and Deputy President *ex officio* and about 17 other members drawn from vehicle and component suppliers. The Executive Committee is appointed by the SMMT Council, a body of about 60 members, drawn from the various sections, and appointed by the membership.

9.14. It appeared, from the minutes of meetings of the Executive Committee, that (in discussion with the Department of Trade) it had adopted the VER policy in 1975 and implemented it thereafter through the discussions with JAMA. The SMMT's officers believed that this policy had the support of the membership; they were not aware of any disagreement with it or with the discussions at any stage, and said that the members must be responsible for the SMMT's policy and actions.

9.15. It appeared, from the minutes of meetings, and copies of letters exchanged, between the SMMT and the Government, that the VER policy had been conducted by the SMMT with the full support of the Government at all relevant times.

9.16. We noted, from a reply by the Chancellor of the Duchy of Lancaster to a Parliamentary Question on 26 April 1988, that-excluding vehicles-there had been 16 VER agreements in the United Kingdom, relating to monochrome and colour television sets, music centres, pottery, stainless steel cutlery and footwear, but that all had lapsed by the end of 1987.

## Restrictions in other EC member states

9.17. Within the EC there are four other member states in which there are national restrictions on new car imports from Japan. In France the Japanese share of the market is limited to 3 per cent under an arrangement that has been in place since 1977. In Italy a quota agreement negotiated in 1952 setting limits to car exports in both directions allows Japanese exports of 2,200 per year (although it is estimated that a further 14,000 Japanese cars are imported into Italy from other EC countries, so that Japanese penetration of the Italian market amounts in all to less than 1 per cent). In Spain a quota allows exports of 12,000 cars a year direct from Japan and a further 6,000 from Japanese companies operating in Europe. This amounts to less than 1 per cent of the Spanish market. There is also a small quota for Portugal. For convenience, in our analysis of the effects of restrictions in paragraphs 9.22 onwards, we use the term VERs to describe all these national restrictions.

9.18. In Germany, Japanese suppliers exercised a degree of restraint at the start of the 1980s, and the Japanese market share has been stable at about 15 per cent since 1986. This might be thought to imply the existence of a VER, but the German Economics Ministry told us that it had no knowledge of any VERs currently exercised by Japanese suppliers.

9.19. Since the beginning of the 1980s the EC Commission has had a role in the negotiations with the Japanese. In 1988 the Japanese limited their vehicle exports to 1.21 million of which 1.04 million were cars and amounted to 8.8 per cent of EC sales. The EC Commission has now taken over the discussions with the Japanese from national authorities. The new arrangements, agreed in July 1991, provide a framework for the period up to the end of 1999, after which it is envisaged that VERs will cease. The new arrangements are discussed in more detail in paragraphs 9.56 to 9.66.

## VERs outside the EC

9.20. In the United States, Japanese suppliers adopted a VER in March 1981. Since then it has been periodically extended and modified. The current VER is less restrictive than previously; it now allows imports from Japan of 2.3 million cars a year (about 24 per cent of the United States market). The significance of the VER has been very much reduced by the establishment of production facilities in the United States by Japanese companies. The volume of production from this source expanded considerably during the 1980s and currently amounts to around 1 million cars a year (supplying 11 per cent of the market). Imports from Japan are now substantially less than the level allowed by the VER.

9.21. In Canada, Japanese suppliers accepted a limit in 1982 of 18 per cent of the market; in 1986 the limit was increased to 21 per cent.

## Effects of VERs

9.22. In this section we first consider what effects might be expected from the introduction and operation of VERs. We then discuss the results of two studies, firstly an investigation by the Organisation for Economic Co-operation and Development (OECD) into VERs in a number of countries, and secondly a paper prepared by the Cardiff Business School (CBS) on trade in cars in the EC. Finally we consider what further evidence is available to enable us to assess the present position.

### *Analysis of possible effects*

9.23. We begin the analysis by considering the main effects of VERs in the simplified case where domestic producers are protected by a VER from a low-cost importer. There would be a higher price level than would otherwise prevail, and total sales in the market would fall to a greater or lesser degree. Domestic producers would have a higher level of output and employment. The low-cost importer would achieve a higher rate of profit on a lower level of sales. The steps in this analysis are described in more detail in Appendix 9.1.

9.24. Thus consumers would lose in that they would be paying higher prices, while domestic producers would gain in that their output and employment would rise. The effect on the low-cost importer is more difficult to evaluate but it can be expected that he would earn a higher rate of profit on a lower volume of sales.

9.25. A VER, like a formal quota, has been seen in principle as an inferior method of trade protection compared with a tariff. The main advantage of a tariff as opposed to a VER is that it secures for the Government a gain in revenue that under a VER would have passed to the importer as profit.

9.26. The general approach to the effects of VERs applies whether the protected territory is a single country or a group of countries that have combined to form a customs union (a description that would apply to the EC). In the latter case the price effect of a VER applied to one of the countries of the customs union will eventually be to raise the price level for all countries, since competitive forces will tend to equalise prices throughout the customs union. Provided producers in the various countries are not constrained with respect to productive capacity or access to technology, they will continue to compete in those countries that have VERs both through imports and by means of cross-border investment and this will tend to eliminate any inter-country price differentials that may have arisen on the introduction of VERs.

9.27. The application of this analysis to the EC market has to be qualified in two ways. First, EC producers differentiate their cars both from each other and between countries and this has the effect on the demand side of blunting responses to price differences. Secondly, EC markets are segmented by a number of factors, in particular technical differences (especially, in the case of the United Kingdom, the requirement for RHD cars) and the effects of the distribution system. Not only do these factors hamper any attempts at arbitrage between national markets, they also help to preserve any price differences that arise from differing national tastes. The process by which prices are equalised across national boundaries as outlined in the previous paragraph may take a long time to achieve and will not affect any divergencies of price that are of short duration.

9.28. VERs may also have an effect on the range of models imported, and hence on consumer choice. Most of the Japanese producers that export into the EC manufacture a wide range of cars. The exports of a given supplier may not, however, represent the whole range where the market share is small because of the costs of holding stocks, of meeting differing national requirements, and of promoting and servicing different model ranges. The effect of the VER will be greater in those countries where the limit on exports is very low, but may also exist in countries like the United Kingdom with a higher VER in respect of the smaller suppliers at least. Thus where a VER has the effect of restricting the market share of a supplier to a level much lower than it would be under competitive conditions and where the constrained level is very low, consumer choice is likely to be reduced in terms of the range of models available.

9.29. It is generally accepted in the car industry that within a model range profits are generally higher for variants with higher specifications. Where a supplier is limited to selling at a level below his competitive potential he therefore has the incentive to focus his selling effort on those higher specification variants. The supplier may also wish to try to maximise the number of cars sold in his more expensive model ranges (to the extent that he is exporting them to the particular national market in the first place) as the amount of profit earned on the more expensive cars will generally be larger.

9.30. All of these effects on product choice are likely to be exacerbated by faster product development. The Japanese suppliers have taken the lead in increasing the rate at which new models are brought to the market, and VERs may make it more difficult for consumers in the United Kingdom to benefit from the same access to the latest models that would be available in an unrestricted market.

9.31. The effects of VERs on the level of output and employment in the protected country will be different in the short term from the long term. In the short run the VER limits the market penetration of the suppliers to which it applies by limiting their imports, but in the long run those suppliers can increase their market penetration through local production.

9.32. In the period before investment in local production takes place the level of total domestic output will depend primarily on the relative success of existing local producers in competing for sales against those importers which are not affected by the VER. The longer this period the more important the dynamics of competition between domestic producers and importers. It is also in this period that the domestic producers have an opportunity to rationalise production systems so as to increase levels of productivity and be in a better position to compete when either the VER comes to an end or the affected suppliers set up domestic production facilities.

9.33. The objective of increasing productivity will not be attained if the protection provided to the domestic producers has the effect of dampening their competitive efforts. Domestic car producers in the United Kingdom may lose market share through lack of competitive effort to other European suppliers such as Volkswagen or Renault just as they could in an unrestricted market to Toyota, but the former threat may not represent so serious or so plausible a prospect to the domestic producer as the latter. While therefore the VER may provide the opportunity for rationalisation it may also reduce the incentive.

9.34. When in the longer run the suppliers affected by the VER invest in local production, the impact on existing local producers will depend on the extent to which they have become as efficient as the new local producers. If they succeed in this, the long-run effect of the VER will have been largely to replace the imports of the more efficient foreign producers with their own local production. If the original local producers do not succeed in equalling the levels of efficiency of the new producers, the long-run level of output and employment will depend on the extent to which they also lose market share to other importers, but the main effect of the VER of replacing imports with local production will be the same. This scenario also assumes no governmental action to restrain or encourage higher investment in local production by the more efficient foreign producer.

9.35. It may not be clear, however, whether the decision to invest in local production should be attributed to the existence of VERs as opposed to other factors affecting a supplier's international strategy for the location of production-and this will especially be so where the chosen country is part of a customs union. One country may be seen as providing a more advantageous manufacturing base than another, and the investor may be influenced by government incentives. A foreign producer may have decided on local production-a decision perhaps accelerated or even caused by the existence of VERs-and in the case of a customs union will then assess the merits of different countries in order to choose one (or perhaps more than one) for local production.

## *Other studies on VERs*

9.36. We have been able to identify only one detailed study done in the last few years of the economic impact of VERs on the car industry. This was carried out by the OECD in 1987,[1] and covers principally the period 1975 to 1985. We have also made use of a more recent study, commissioned by the National Consumer Council (NCC) and carried out in 1989 by Professor Garel Rhys and Dr John Bridge, of the CBS, which has some analysis of the possible effects of VERs on prices and their cost to consumers.

9.37. The main conclusions of the OECD study for the United Kingdom were that prices were probably some 10 per cent higher because of the VER in the years up to 1982 but after that the effect of the VER on price may have become of lesser importance. The OECD considered that in the absence of a VER the Japanese suppliers might have taken up to 20 per cent of the United Kingdom market. The effects on domestic output and employment were found to be slight because of the increasing share of the market being taken by other importers. The study also concluded that the VER had played only a small role in attracting Japanese investment to the United Kingdom. On the other hand it was probable that the protection provided by the VER delayed the process of adjustment and rationalisation within the industry by up to two years. It did, however, the study concluded, enable British Leyland to remain a competitive force in the market.

9.38. The effect of VERs on prices in other countries varied considerably, according to the OECD study. For one period in the United States the price effect may have been between 15 and 25 per cent, although it fell later when the size of the VER quota was increased. In Canada the effect of the Japanese VER was much less because (the study suggests) of the unrestricted imports of Korean cars. In France the price effect was estimated at between 7 and 9 per cent in the early 1980s. As for Japanese investment the OECD thought that the VER had made a major contribution to investment in the United States but there had been no significant effect in the case of either Canada or France. Employment gains were found to be modest in all countries.

9.39. The main conclusion of the CBS study was that, based on a difference in prices of some 20 per cent between the United Kingdom and Japan, the Japanese market share for the EC as a whole would rise to around 20 per cent if there were no VERs. The cost to EC consumers of retaining VERs would amount to around £1.6 billion per year.

9.40. A detailed account of the two studies is provided in Appendix 9.2.

## *More recent evidence on the effects of VERs*

9.41. In order to provide some yardstick against which to estimate the possible effects of VERs on the prices of cars in the United Kingdom we commissioned a firm of consultants[2] to carry out a study comparing the prices of a sample of Japanese cars in the United Kingdom with those of model variants in Japan chosen to correspond as closely as possible. To provide a further yardstick the study also includes prices for a sample of the corresponding model variants in the United States. As a second exercise we have looked at the level of prices in different countries of the EC and compared their relative levels with the restrictiveness of VERs in each country.

9.42. In the study of prices of Japanese cars, we sought to compare list prices in the United Kingdom with the price which would have to be paid by a notional private customer importing corresponding model variants from the United States and Japan. As explained in Chapter 8, a comparison of this kind requires adjustments to be made for differences in specification. Consideration has also to be given to the treatment of taxation, transportation costs and exchange rates.

9.43. The United States was selected as a useful comparator since in common with the United Kingdom (and the rest of the EC) it is a major export market for the Japanese suppliers. It is now generally regarded as an open and competitive market.

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[1] *The costs of restricting imports: the automobile industry*.

[2] Cedric Ashley and Associates (CAA).

9.44. The criterion that model variants should be closely comparable with one another proved more restrictive here than in the case of the LAL study as there is less comparability of cars between Japan, the United States and the United Kingdom than between the countries of the EC. Japanese and United Kingdom cars do at least have in common the fact that they are RHD. Cars produced by all four of the largest Japanese suppliers have been included. TMC told us, however, that it does not accept that the Toyota variants within each model range are closely comparable. Table 9.2 provides details of the model ranges and variants included in the study.

TABLE 9.2 **Cars selected for the CAA study**

| *Manufacturer* | *Model range* | *Model variant* |
|---|---|---|
| Honda | Civic | GL, 3-door hatch |
| | Accord | 2.0i, saloon |
| Mazda | 626 | GLX 2.0, 4-door saloon |
| | MX5 | Sport Open |
| | RX7 | Turbo Coupé |
| Nissan | Sunny | 1.4, 3/4-door saloon |
| | Primera | 2.0i ZX, 4-door saloon |
| | 200 | SX, Sport Coupé |
| Toyota | Corolla | GL 1.3/4, 4-door and 3-door hatch |
| | MR2 | GT, Sport Coupé |
| | Celica | GT, Sport Coupé |

*Source*: CAA.

9.45. For each car a comparison was made between the list price in the United Kingdom and the prices that would be paid for the same car if imported from Japan or from the United States. A large number of adjustments were made to the Japanese and United States prices to reflect as far as possible the market prices of different specifications. The methods used were very similar to those of the LAL study reported in Chapter 8. Adjustments were also made for different rates of taxation between countries and for shipment costs between Japan and the United Kingdom (including transport, insurance, preparation, customs clearance and working capital costs), which were taken to be between £400 and £500 depending on the size and value of the car. Current exchange rates were used. The resulting price comparison is set out in Table 9.3.

TABLE 9.3 **Prices of Japanese cars, May 1991**

*£*

| *Manufacturer* | *Model range (model variant as in Table 9.2)* | *United Kingdom* | *United States* | *Japan* |
|---|---|---|---|---|
| Honda | Civic | 10,495 | 8,518 | 6,467 |
| | Accord | 16,350 | 13,319 | 12,082 |
| Mazda | 626 | 12,586 | 11,369 | 10,427 |
| | MX5 | 15,581 | 12,732 | 11,602 |
| | RX7 | 23,090 | 20,832 | 17,071 |
| Nissan | Sunny | 9,497 | - | 6,004 |
| | Primera | 17,366 | 13,676 | 12,940 |
| | Nissan | 16,346 | 13,458 | 12,383 |
| Toyota | Corolla | 9,653 | 8,355 | 6,723 |
| | Celica | 19,128 | 15,515 | 12,912 |
| | MR2 | 17,074 | 14,161 | 13,007 |

*Source*: CAA.

9.46. Table 9.4 presents these price comparisons in index form with the actual price in the United Kingdom taken as the base. As shown in the table, prices for the variants selected for the study in the

United States were found to be on average some 16 per cent lower than those for the corresponding variants in the United Kingdom, and those for the variants available in Japan were on average some 28 per cent less. The largest price differential was found for small cars, where prices for those available in Japan were on average some 35 per cent lower than prices for the corresponding model variants in the United Kingdom. A higher price differential for the small car segment would be consistent with the findings of the LAL Report in respect of price differentials between EC countries.

TABLE 9.4 **Indices of prices of Japanese cars, May 1991**

| | | | | £ |
|---|---|---|---|---|
| *Manufacturer* | *Model range (model variant as in Table 9.2)* | *United Kingdom* | *United States* | *Japan* |
| Honda | Civic | 1.00 | 0.81 | 0.62 |
| | Accord | 1.00 | 0.81 | 0.74 |
| Mazda | 626 | 1.00 | 0.90 | 0.83 |
| | MX5 | 1.00 | 0.82 | 0.74 |
| | RX7 | 1.00 | 0.90 | 0.74 |
| Nissan | Sunny | 1.00 | N/A | 0.63 |
| | Primera | 1.00 | 0.79 | 0.75 |
| | 200 | 1.00 | 0.82 | 0.76 |
| Toyota | Corolla | 1.00 | 0.87 | 0.71 |
| | Celica | 1.00 | 0.81 | 0.68 |
| | MR2 | 1.00 | 0.83 | 0.76 |
| Average | | 1.00 | 0.84 | 0.72 |
| Small car average | 1.00 | 0.84 | 0.65 | |
| Medium car average | 1.00 | 0.83 | 0.77 | |
| Sports car average | 1.00 | 0.84 | 0.74 | |

*Source*: CAA.

9.47. TMC told us that it rejected the validity of the results of the study. Because of the large number of differences in specification, it did not accept that adjustments could be made to prices adequately to reflect those differences. It rejected those adjustments which were based on estimates of perceived market value made by the consultants when options prices were not available, on the grounds that such estimates might bear no relationship to the actual value of the specification differences, and ignored some specification differences which were not `perceived' in terms of market value. It pointed out that a contributory factor to list price differences between the United Kingdom and Japan was the existence of an additional layer of distribution in the former which was not included in the calculations. However, since it did not provide alternative estimates we are unable to comment on the substance of its arguments.

9.48. Mazda also commented on the way the study was done. It considered that a somewhat larger allowance should be made for the shipping and related costs and that some account should be taken of the fact that prices in Japan are not normally changed over the life of a model variant, which was usually about two years. We did not receive any comments from other suppliers on the way the study was done. Whilst we note the points made by Toyota and Mazda, we do not consider that they are likely to make a significant difference to the magnitude of the overall price differences identified by the study.

9.49. The price comparisons relate, as explained, to list prices. A conversion of list prices to transaction prices would require, as described in Chapter 8, some adjustments for the different levels of consumer discount and financial benefits available in each country. Discounts are available in both the United States and Japan as well as in the United Kingdom. But even if discounts and financial benefits are significantly larger in the United Kingdom than in the other two countries, substantial differences in transaction prices would remain, particularly in relation to Japan.

### *Price levels and VERs in EC member states*

9.50. As mentioned in paragraph 9.41, we also considered the relationship between the price levels in a number of EC countries and the restrictiveness of national VERs (where they exist).

9.51. Table 9.5 provides a comparison of relative prices (on an index basis) in six EC countries with the levels of VER in each country. Both list prices and transaction prices are shown (in both cases net of tax and adjusted for specification) and are drawn from our analysis of the results of the LAL Report (see Tables 8.7 and 8.19).

TABLE 9.5 **Relative prices and VERs in five EC countries, 1990**

| | *Relative price index* | | | |
|---|---|---|---|---|
| | *Specification-adjusted list price* | *Transaction price* | *Level of VER** | *Japanese share of market** |
| United Kingdom | 100 | 100 | 11 | 10 |
| Germany | 88 | 96 | nil | 16 |
| France | 83 | 94 | 3 | 3 |
| Belgium | 81 | 88 | nil | 20 |
| Netherlands | 80 | 89 | 20 | 27 |

*Source*: MMC calculations based on LAL data.

*As a percentage of the national market.

9.52. From these figures it is difficult to see any relationship between relative price levels and VERs. While the Netherlands and Belgium are in the position that would be expected if VERs had a significant effect on national price levels, France and Germany should then be far apart, and the relative positions of the United Kingdom and France would be reversed. While therefore the national VERs are likely each to contribute to the price differential between the EC and Japan, this evidence would not indicate that they have any significant impact on price differentials between countries. This conclusion is consistent with the general expectation discussed in paragraph 9.26 that competitive forces will operate in the direction of price equalisation across the borders of a customs union.

## Recent developments

### *Japanese investment in the United Kingdom*

9.53. As in the United States a decade earlier, it seems likely that the supply of Japanese cars to the United Kingdom (and probably the whole EC) market will be transformed by major investment on the part of the main Japanese suppliers. While the VER was established in 1975, it was clearly several years before decisions were made to carry out major investment. The United Kingdom was the EC country in which Japanese suppliers showed most interest.

9.54. Some Japanese suppliers decided on a joint-venture approach in establishing manufacturing facilities within the EC. Honda has entered a wide-ranging joint venture with Rover. Mazda has agreed a joint venture with Ford that is expected to lead to manufacture in Germany. Mitsubishi is similarly planning to establish joint venture manufacture, in this case with Volvo in the Netherlands. However, the two leading Japanese suppliers, Toyota and Nissan, have preferred to act independently.

9.55. All the major investments within the EC in new car plants that are currently under way are located in the United Kingdom. Nissan has already started production in Sunderland, and expects to produce around 120,000 cars in 1991. This should be approximately doubled two years later. Toyota's plant at Burnaston (in Derbyshire) is due to come on stream at the end of 1992, and is expected to produce some 200,000 cars by 1995. Honda is due to commence its commercial production a little earlier, in the autumn of 1992, and may reach around 100,000 by 1995. Thus the output of Japanese cars in the United Kingdom by 1995 is expected to reach at least 550,000, and this is likely to form the major proportion of the output planned by Japanese suppliers in the EC as a whole. The Economist Intelligence Unit (EIU)[1] has estimated that the figure for the EC as a whole in the same year is likely to be some 810,000.[2] It is difficult at this time to make forecasts for further ahead since additional investments will depend upon the success of the earlier ones-and this has still to be seen. The EIU forecast is for approximately an additional 60 per cent by 1999 over the 1995 level for Japanese cars produced in the EC. By comparison the EC Commission in negotiations with the Japanese (as described in the next section) appears to be expecting a level around three-quarters of the EIU figure. If the countries of Eastern Europe become member states of the EC, the figure for production in the EC will rise further. So far only Toyota and Suzuki have announced plans to produce there.

## *EC negotiations with Japan*

9.56. The EC Commission has had a role since the beginning of the 1980s in the negotiations regarding VERs. More recently the EC Commission has been in discussion with the Japanese Government with a view to making arrangements on an EC-wide basis that would supersede national VERs. The results of the discussions were announced in July 1991. The main points announced were that VERs should continue until 1999, that there should be no restrictions at all on Japanese cars produced within the EC and that there would be no restrictions at all from the year 2000. There remain, however, areas of uncertainty, in particular relating to the way in which VERs should be relaxed in the period leading up to 1999.

9.57. The results of the discussions will be notified to the GATT and were accompanied by public statements by Mr Andriessen, Vice-President of the EC Commission, and Mr Nakao, Japanese Minister of International Trade and Industry. In an EC document (so far unpublished) the results are described as `elements of consensus'. There are four main `elements': the objectives, the means or measures, the `forecasts' and the `monitoring' system. The objectives reflect the joint desire of the two sides to move towards full liberalisation of the EC market via a transition period in which `disruption of the market' by Japanese exports would be avoided, thus allowing EC suppliers a further opportunity to adjust `towards adequate levels of international competitiveness'. The means and measures by which the objectives are to be achieved are principally those described in the previous paragraph together with the adoption of EC-wide type approval by 1993. The measures would supersede all national restrictions.

9.58. The `consensus' and the public statement by Mr Nakao establish `forecasts' for Japanese exports in 1999 both at the EC level and for the five countries that have national VERs. They cover cars, off-road vehicles and light commercial vehicles. The `forecasts' are described as based on certain demand assumptions (again relating to 1999) for the EC and each of the five countries. In terms of percentages of the relevant market, the `forecasts' are 8 per cent for the EC as a whole, and 7 per cent for the United Kingdom, 5.3 per cent for each of France, Italy and Spain, and 8.4 per cent for Portugal. There is to be a `smooth trend' of exports to the 1999 levels. It is not clear how the national `forecasts' have been calculated. The United Kingdom one is lower than the existing VER of around 11 per cent. The EC Commission has said that one of its `working assumptions' is that by 1999 1.2 million vehicles (of which the vast majority would be cars) will be produced by Japanese factories located in the EC. By that date roughly half of the sales of Japanese cars in the EC would be imported and half locally produced, according to the EC scenario.

9.59. The `forecasts' are to be `monitored' both at the EC level and at the level of each restricted market. Consultations are to take place twice a year and may adjust the `forecasts' in the light of `market developments'. The `consensus' itself does not provide much indication of how such adjustment may be done. It is to be done `in an equitable manner' and `Japan bears in mind' the EC view that EC suppliers should enjoy `the adequate benefit of growth'. There is also a reference to Japanese cars produced in the EC: the Japanese side will convey to the Japanese suppliers the EC concern to avoid `market disruption' through an `excessive concentration' of sales of EC-produced cars in particular national markets.

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[1] *Japanese Motor Business*, June 1991.

[2] Excluding so-called `space' or utility vehicles (eg the Range Rover or the Nissan Patrol).

9.60. The EC approach to adjustment of the `forecasts' is somewhat clarified by a document described as an `internal declaration'. It provides an interpretation, on two points, of the way in which `forecasts' should be adjusted when actual trends differ from the planned scenario. First, EC suppliers should benefit from at least one-third of the growth of the market; and secondly, when demand is expected to fall to below a `forecast' level, Japanese exports should be reduced by three-quarters of the shortfall. It is, however, by no means clear how this approach would operate in practice.

9.61. It is not clear what role national authorities are to play in the arrangements for the rest of the 1990s. One of the `means and measures' is the abolition of all restrictions applied by national authorities, but the document does not specify who on the EC side should carry out the `monitoring' of the new VERs and there may be a role for national authorities here in conjunction with the EC Commission. It is moreover the view of the DTI that a national authority may if it wishes relax or end the VER that applies to its national territory.

9.62. One statistical difficulty in interpreting the `forecasts' is that the absolute numbers in the `consensus' refer to a combination of cars, off-road vehicles, light commercial vehicles and light trucks, but there is no indication of how far any one of these categories is seen as substitutable for another. While cars form the vast majority of the total number of vehicles, it is not clear whether in the bi-annual discussions either side will expect that the proportion of each category of vehicle should remain approximately the same within the total. In the case of the United Kingdom the `forecast' level of Japanese exports (for 1999) is 190,000 for vehicles of all categories. If these were divided in the same proportions as under existing VERs, around 165,000 would be cars.

9.63. The major uncertainty surrounding the `consensus' concerns the way in which the bi-annual `monitoring' is to work if demand departs substantially from the forecasts on which the `consensus' is based. While the EC side may have reached its own view on the way it would like negotiations to go in those circumstances (as described in paragraph 9.60), the `consensus' itself contains little more than expressions of goodwill.

9.64. A further uncertainty is the way in which the Japanese will divide the VER total between suppliers. Hitherto this appears to have been done on the basis of historical market shares with some adjustment to take account of developments in sales performance. But the growth of a local production capability in the case of the leading Japanese suppliers and the exceptional distribution problems currently faced by Nissan may make this method no longer realistic. It may not be clear until 1993 how the Japanese will allocate shares of the VER total.

9.65. The likely impact of the `consensus' on Japanese penetration of the EC market will also very much depend on the level of Japanese output within the EC and the way it may be taken into account in the bi-annual `monitoring'. The `consensus' envisages that by 1999 the Japanese suppliers will be producing almost as many cars within the EC as they import from Japan. On this basis the Japanese market share in 1999 would be 16 per cent of the EC as a whole. If, however, Japanese production within the EC were much higher-and the EIU, as well as the DTI, foresees a higher figure, the Japanese share of the EC market could reach 20 per cent or more. The `consensus' is quite clear that it is only imports that are still to be restricted: point 3 of the agreement says that there will be no restrictions on Japanese investment or on the free circulation of its products in the EC. The EC Commission has, however, indicated that it sees the `forecasts' as based on a working assumption that 1.2 million vehicles would be produced in Japanese factories in the EC in 1999.

9.66. All perhaps that is clear from a reading of the `consensus' is that if the EC scenario proves realistic, Japanese suppliers are likely to have a 16 per cent share of the EC market by 1999, of which around half will be locally sourced, and that full liberalisation of the market will follow in the year 2000.

## A look forward

### *The impact of the new arrangements on the United Kingdom market*

9.67. The difficulties of predicting the effects of the EC/Japan `consensus' at the EC level are all the greater at the national level. If, in accordance with the `consensus' and with the Treaty of Rome, free circulation is allowed throughout the EC for Japanese cars produced within it, it will be for individual Japanese suppliers, given their share of the VER total, to decide how far to promote sales in individual countries.

9.68. The `forecasts' for Japanese imports in 1999 cannot provide much guidance on the likely distribution of locally-produced cars, since the current Japanese market shares in the Netherlands, Belgium, Ireland and Germany are already relatively high and it is therefore unlikely that these countries could take a larger share of locally-produced cars as well as of imports. The main marketing opportunities would appear rather to be among the countries whose market shares are currently restricted by VERs.

9.69. Among these the United Kingdom might appear to offer the best short-term opportunities as the main Japanese suppliers are already well known and well established and have major distribution systems in place. It may also assist Japanese sales in the United Kingdom that many of the cars on sale will be locally produced. In the longer term, however, France, Italy and Spain are likely to present the greater opportunities, if only because Japanese market shares there are currently low.

9.70. How far the Japanese suppliers will succeed in increasing their market share in the United Kingdom by the year 2000 will depend both on the strength of the other suppliers and also on the individual strategies of the Japanese companies. The leading companies (Toyota, Nissan and Honda) will each have to choose not only what targets to adopt in the differing markets of the EC but also what financial objectives to set themselves. A strategy for the 1990s based on maximising market share would be different from one that sought high returns. For its part Nissan has announced a target of 9 to 10 per cent of the United Kingdom market by the end of the decade. If Toyota and Honda sought to double their (rather smaller) current shares and the smaller Japanese suppliers merely retained their current shares, the total Japanese share of the United Kingdom market would be around 17 per cent by the end of the decade.

9.71. If both this forecast and the EC forecast for Japanese sales in the EC as a whole proved correct (ie 17 per cent for the United Kingdom and 16 per cent for the whole EC by the year 2000) the degree of restraint on Japanese suppliers would be decidedly less than under the VER regime that existed in the 1980s. However, to judge from unrestricted markets like the United States, the Japanese market share would still be constrained at that level and would be likely to grow further in the period after 1999 when, according to the `consensus', no restrictions would exist at all.

9.72. The degree to which individual Japanese suppliers might feel constrained in the period up to the year 2000 will doubtless vary, and will depend in part on the way in which shares of the VER total are allocated. The assumptions on market share made in paragraph 9.64 would imply that the three leading suppliers would receive somewhat lower shares of the United Kingdom VER total and the smaller suppliers' rather higher shares under the new regime. The degree of constraint would also depend in part on each supplier's ambitions and commitment to playing a larger role in the market.

9.73. The effects of the `consensus' on Japanese cars sold in the United Kingdom may also be considered in terms of the level of domestic production. It is, however, difficult to reach any conclusion as it is not clear what will be the impact on other suppliers of the expected increase in the overall Japanese market share. If the brunt of the Japanese gains were borne by those suppliers that have domestic production facilities, there is a greater chance that total domestic production might be reduced; but the reverse might also be the case and more of the burden of adjustment might fall on other imports. By themselves the changes foreseen for the 1990s in the supply of Japanese cars are likely to mean an increase in the share of the market taken by domestically-produced cars. As Japanese local production replaces some of the Japanese imports, the share taken by those imports is expected-under the EC Commission scenario-to fall from around 10 per cent to around 7 per cent by 1999. Assuming, as in paragraph 9.70, a total Japanese share in 1999 of 17 per cent, the share of all domestically-produced cars would rise from 43 per cent in 1990 to between 46 and 53 per cent in 1999, as the cars displaced by the higher Japanese share were domestically-produced or imported.

9.74. The effects of the `consensus' for the United Kingdom are therefore likely to be a relaxation of the constraints on the Japanese suppliers leading to an increase in their market share. The share of all domestically-produced cars is also likely to rise as the Japanese suppliers expand production in the United Kingdom. It is difficult, however, to quantify the size of these effects with any degree of certainty.

### *The effects of a more rapid liberalisation of the United Kingdom market*

9.75. An overall Japanese share of the United Kingdom market of around 17 per cent by 1999 would still appear to constitute a constraint for some if not all Japanese suppliers, ie there is likely to be potential for higher Japanese sales before that date. To judge by other unrestricted markets, but taking into account the existence of a major domestic industry, the Japanese share of the United Kingdom market, if unconstrained, could rise to some 25 per cent or even more. We therefore consider what effects might be foreseen if the EC Commission `forecasts' were amended (as a result, for example, of intervention by the United Kingdom authorities) so that the VER for the United Kingdom was removed or at least raised sufficiently to ensure that Japanese sales were under no constraint at all from 1993 onwards.

9.76. The Japanese suppliers will continue to rely to a substantial degree on imports for increasing market share during the 1990s. This will vary by supplier. Some suppliers, for example Nissan, expect by 1995 to be producing two model ranges in the United Kingdom, and will therefore be less constrained by the continuing VER. Others, for example Mazda, do not have any plans for local production and will be entirely dependent for United Kingdom sales on their VER allocation. If the VER were terminated and there were no constraints at all on imports into the United Kingdom, the main beneficiaries would appear to be those suppliers like Mazda which expect to rely wholly on imports. By 1999 there would be only 7 per cent of the market (under the `consensus' scenario) to be allocated among all the Japanese suppliers that wished to export to the United Kingdom. While the degree of constraint on individual suppliers will depend on their allocations, it can be expected that the early abolition of the VER would release additional competitive pressures from a number of Japanese suppliers with consequent effects on prices.

9.77. The effect of early liberalisation of the United Kingdom market on the shares of suppliers cannot be quantified. Nor, therefore, can we estimate the resulting effects on domestic output and employment. However, whatever these effects may be, they are likely to be small compared with the competition forces already unleashed by Japanese investment and the EC/Japan `consensus' to liberalise the market by the year 2000. The main determinant of changes to market shares and to domestic output and employment in the medium and longer terms will be the speed of response of other suppliers to Japanese pressures through programmes of rationalisation and investment designed to bring about major improvements in productivity.