

spotlight

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AUTO DEALER PROTECTIONISM

State Limitations on Dealer Competition Should Be Eliminated

SUMMARY: North Carolina law limits the establishment and relocation of new-vehicle dealerships in “relevant market areas” where the same make of car is sold. This law was enacted due to the belief that dealers were in an unequal bargaining position with manufacturers. This rationale is now obsolete. Research also indicates that such laws hurt consumers. No justification exists to continue granting special privileges to dealers, especially when those privileges come at the expense of the public.

On August 23, 2005, the North Carolina General Assembly ratified H.B. 1227, a bill that amends the state’s motor vehicle franchise laws.¹ Specifically, the legislation adds a new way for existing motor vehicle dealers to relocate their operations. While the provision garnered attention due to the possibility that it was inserted into the bill for a specific Wake county car dealership, the bill raises an even bigger question.²

Why does North Carolina have a regulatory scheme that limits the establishment of new motor vehicle dealerships and the relocation of existing dealers?

North Carolina’s Relevant Market Area (RMA) Law

As in many other states,³ North Carolina has a relevant market area (RMA) law—this law establishes limitations on the creation and relocation of dealerships selling new motor vehicles. Manufacturers must notify the Commissioner of Motor Vehicles prior to entering into a franchise agreement with a new dealer or relocating an existing dealer in a “relevant market area” where the same make of car already is represented.⁴ A relevant market area generally is defined as “the area within a radius of 20 miles around an existing dealer or the area of responsibility defined in the franchise, whichever is greater.”⁵ If a manufacturer seeks to establish a new franchise, the “relevant market” can have an area within a radius of 10 or 15 miles of the proposed site or within a radius of 20 miles of an existing dealer, depending on the population.⁶

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A detailed administrative process exists that permits dealers selling the same make of car in the RMA to protest the proposed action. The manufacturer may not move forward with its plans until a hearing has been held to determine if “good cause” exists to grant the request⁷—the burden of proof is on the manufacturer.⁸ There are some narrow exceptions to the general notification requirement, most of them addressing the relocation of existing dealers.⁹

Original Rationale for the Law

In 1955, North Carolina enacted legislation that regulated the distribution of motor vehicles. The RMA provision was not included in this legislation until 1983.¹⁰ The purpose of regulating the manufacturer-dealer relationship was to protect motor vehicle dealers from manufacturers. State laws regulating the manufacturer-dealer relationship were enacted as far back as the late 1930s.¹¹

A 1956 United States Senate report outlined the major concerns and reasons for regulating the manufacturer-dealer relationship:

Automobile production is one of the most highly concentrated industries in the United States, a matter of grave concern to officers of the Government charged with enforcement of antitrust laws. Today, there exist only five passenger-car manufacturers, three of which produce in excess of 95 percent of all passenger cars sold in the United States...

Dealers are with few exceptions completely dependent on the manufacturer for their supply of cars...the dependence upon a single manufacturer for supply of automobiles, and the difficulty of obtaining a franchise from another manufacturer all contribute toward making the dealer an easy prey for domination by the factory.¹²

All of the reasons that existed back in 1956 as outlined in this report are non-existent today (as they were in 1983). As should be expected, the elapse of a half-century has created very different market conditions. The original rationale for the laws has disappeared.

A New Marketplace

Markets are not static — laws that are premised on market conditions must reflect the dynamic nature of markets and take into account whether the original conditions still exist. Several key changes have taken place that drastically altered the marketplace: intense competition between manufacturers, a major reduction in the number of dealers, and the strengthening of individual dealers.

Manufacturer Competition: A concentrated industry made it difficult for dealers because limited competition gave them few options or leverage if they desired to franchise with other manufacturers. In 1956, the Big Three (generally thought of as General Motors, Ford, and Chrysler) had a market share of over 95 percent in the passenger-car market.¹³ In 2003, for passenger cars alone, their market share had decreased by more than 50 percent — claiming only 47.1 percent of the market.¹⁴ Taking into account light trucks, which comprise a major portion of total motor vehicle sales, the market share for the Big Three was only 61.8 percent of the market in 2003.

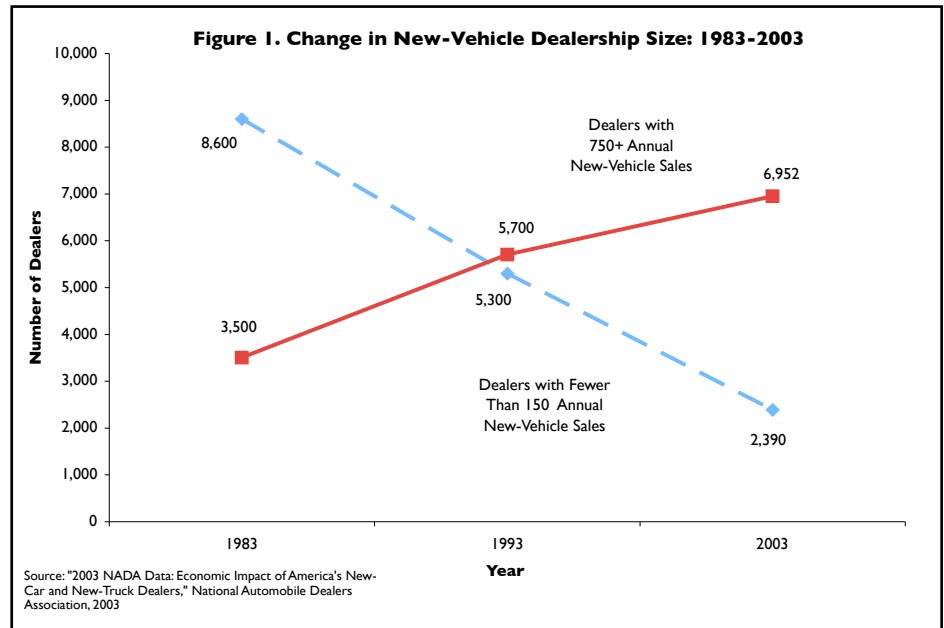
A critical shift in the market has been caused by increased foreign competition. For example, in car sales, foreign manufacturers claimed 34 percent of the market in 1988. In only 15 years, the number increased by more than 50 percent — in 2003, market share was 52.9 percent.

The dominant firm in the industry since 1930, General Motors (GM), is a prime example of the fragmentation of the market. In 1978, GM's market share was at 47.7 percent of the total motor vehicle market (cars and light trucks). In only 25 years, their share had decreased by a staggering 41 percent, claiming only 28.3 percent of the market in 2003.

Reduction in the Number of Dealers: The significant decrease in the number of dealers creates even greater leverage for those dealers that do remain in business. In 1956, there were approximately 40,000 franchised dealers.¹⁵ By 1982, the number had decreased by about 35 percent, and was only at 25,700.¹⁶ Recently, the numbers have continued to decline rapidly from 25,700 in 1982 to only 21,725 in 2003.

Strengthening of Individual Dealers: In conjunction with the reduction in the number of dealers was the strengthening of dealers that remained in business. It no longer can be argued that new-car dealerships are small local businesses that manufacturers can easily control (see graph). According to the *Encyclopedia of American Business History and Biography*:

By the 1980s the trend was toward fewer and bigger dealerships. In contrast to earlier days, many now sold more than one manufacturer's cars, some of them offering a veritable super-market of cars, not only imports, which dealers had begun selling as a sideline in the 1950s, but sometimes cars of competing American automakers.¹⁷



RMA Laws Hurt Consumers

The RMA law, unlike other manufacturer-dealer provisions, directly restrains trade and limits competition. Consequently, it directly harms consumers and, as such, is as much about the dealer-consumer relationship as it is about the dealer-manufacturer relationship.

Research by the Federal Trade Commission (FTC) confirms the harm to consumers. After the release of the Commission's study on RMA laws, then-FTC Director of the Bureau of Economics David Scheffman stated "This study shows that these laws benefit auto dealers at the expense of consumers who pay higher prices for new automobiles."¹⁸

Major research studies have consistently shown that RMA laws increase the price of vehicles for consumers.¹⁹ The FTC found that, on average, car prices were 6.14 percent higher in states that had RMA laws than those that did not have such laws. In rapidly growing areas the prices are 7.63 percent higher, therefore North Carolina as one of the fastest growing states (ranked 9th in percent growth among all states²⁰) could be affected even more than most states.

Conclusion

Government should not be in the business of restricting economic freedom and creating special business privileges. North Carolina's current system places the government in the inappropriate role of determining when and where new dealerships should be created and when and where existing dealers should be relocated. This role is a function of the free market and should be left to the private contractual agreements of manufacturers and franchise dealerships.

If a dealership has not negotiated a promise from the manufacturer to refrain from granting franchises to new dealerships within a specified radius, then this is its own freely made choice. The state should not, in essence, make this promise on behalf of the manufacturer before an agreement has been negotiated between the parties. No justification exists to continue granting special state-created privileges to dealers, especially when it comes at the expense of the public.

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Notes

- 1 North Carolina H.B. 1227 (2005), <http://www.ncleg.net/Sessions/2005/Bills/House/HTML/H1227v3.html>
- 2 Dan Kane & Andrea Weigl "Lawmakers tailor bill for Wake care dealer," *Raleigh News & Observer*, August 24, 2005, <http://www.newsobserver.com/politics/story/2750048p-9187502c.html>
- 3 In 2002, there were 41 states that had laws regulating the creation and relocation of new dealerships. See Mark Cooper, "Bringing New Auto Sales and Service into the 21st Century: Eliminating Exclusive Territories and Restraints on Trade Will Free Consumers and Competition," *Consumer Federation of America*, October, 2002 at 3, <http://www.consumerfed.org/pdfs/autointernet.pdf>
- 4 N.C. Gen. Stat. §. 20-305(5), http://www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_20/GS_20-305.html
- 5 N.C. Gen. Stat. §. 20-286(13b), http://www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_20/GS_20-286.html
- 6 *Ibid.*
- 7 N.C. Gen. Stat. §. 20-305(5)(b). The Commissioner of Motor Vehicles, in determining whether "good cause" has been established, must examine several factors that primarily focus on promoting the public interest.
- 8 N.C. Gen. Stat. §. 20-305(6)(b)
- 9 N.C. Gen. Stat. §. 20-305(5)(a)
- 10 North Carolina S.B. 424 (1983)
- 11 Office of Program Policy Analysis and Government Accountability (Florida Legislature), "Review of the Automobile Manufacturer Licensing Program," p. 1 (1996), <http://www.oppaga.state.fl.us/monitor/reports/PDF/9541rpt.pdf>
- 12 S. Rep. No. 2073, 84th Congress, 2nd Sess. at 2 (1956).
- 13 *Ibid.*
- 14 All industry data obtained from "Autos and Auto Parts Industry Survey," Standard & Poor's, December 23, 2004.
- 15 *Op. cit.*, note 12.
- 16 This and all following dealership data obtained from "2003 NADA Data: Economic Impact of America's New-Car and New-Truck Dealers," National Automobile Dealers Association, 2003, http://www.nada.org/Content/NavigationMenu/MediaCenter/NADADData/20033/NADADData_2003.pdf
- 17 George S. May (ed.), "Encyclopedia of American Business History and Biography: The Automobile Industry, 1920-1980," Facts on File, New York, 1989, at 312.
- 18 "Auto Dealership Restriction Laws Cost U.S. Consumers \$3.2 Billion Annually, According to FTC Economics Study," Federal Trade Commission Press Release (March 13, 1986), <http://www.ftc.gov/opa/predawn/F86/rma.htm>
- 19 See Richard L. Smith II, "Franchise Regulation: An Economic Analysis of State Restrictions on Automobile Distribution," *Journal of Law and Economics* 25 (April 1982): 125-57; E.W. Eckard Jr., "The Effects of State Automobile Dealer Entry Regulation on New Car Prices," *Economic Inquiry* 24 (April 1985): 223-42; Robert P. Rogers, "The Effect of State Entry Regulation on Retail Automobile Markets," Bureau of Economics, Federal Trade Commission, January 1986.
- 20 "State Population Growth: July 1, 2003 to July 1, 2004," North Carolina State Demographics Unit.