MIDP link to car prices must not be ignored

By David Kaplan

There has recently been considerable controversy around the issue of South African car prices. In a recent article, Barnes, Kaplinsky and Morris (BKM) provide some empirical evidence.

In their article, "SA car prices compare favourably" (September 27, Business Report), they show that South African car prices compare favourably with prices in the UK.

As a result, they dismiss the competition commission's finding of a link between the motor industry development programme (MIDP) and higher car prices.

The introduction of data is very welcome. However, the conclusions drawn by BKM are not convincing, for three reasons:

Some of the results are not credible.

- They provide the wrong comparisons; and
- A re-examination of BKM's own data provides further evidence that there is indeed a strong link between the MIDP and local car prices.

The correct comparison is not between South Africa and the UK. A 2002 report published by the European Commission taxation and customs union directorate estimated base prices for EU countries, with base prices defined as the price of the vehicle adjusted for specification differences between markets and excluding all taxes.

The report concluded that "the UK base price is by far the highest in Europe" and assessed UK base prices as 34 percent above the EU average.

A more recent study produced for the European Commission competition directorate provided data on the price differences by specific vehicle model.

This report showed the greatest price differences existed precisely in respect of many of the models selected for comparison by BKM, including the Alfa Romeo 147, the Renault Clio, the VW Golf and the Toyota Corolla.

For these models, UK prices exceeded those of the lowest-cost EU country by between 27 percent and 33 percent. On the data supplied by BKM, this would leave local car prices substantially above those in the EU.

Moreover, the EU itself is not a low-price location. Car prices in the US, for example, are often considerably lower than in the EU. A comparison of South Africa with the US might have yielded a very different set of results.

For example, the list price of the locally produced BMW 325i is about 50 percent higher here than in the US. Allowing for local VAT at 14 percent, this still leaves a wide margin.

National differences in product "specs", quality of make, guarantees, financing arrangements, the quality and pricing of after-sales services and parts make cross-country price comparisons of complex products, such as vehicles, notoriously difficult.

Moreover, most cars are not sold at list prices. There are significant volume and other discounts. The price the consumer pays includes not just the producer cost but also the costs of distribution and sales. These costs, which may be of the order of 30 percent and more, are non-tradable.

As with other non-tradable activities, such as haircuts and restaurants, we would expect South African vehicle distribution costs to be lower than in developed countries.

Consequently, we would expect South African car consumer prices to be significantly lower than in developed countries, even if our car production costs are equivalent.

On fully imported cars, BKM allege that for three models South African prices are lower than in the UK - by as much as 8 percent.

They also claim (incorrectly as we have seen already) that UK prices are equivalent to EU prices.

If - after allowing for shipping, transport and handling charges, let alone any duties paid - South African prices are indeed lower than in the country of production, European car producers are actually dumping on local markets. This is scarcely credible.

The measured higher South African consumer prices are more likely to reflect a combination of lower local sales and distribution costs, the inappropriateness of list price comparisons and especially the high cost of cars in the UK.

Regarding budget cars, BKM's direct comparisons show that the list prices of cars produced locally are 20 percent higher than in the UK.

A car selling here for R120 000 would accordingly sell in the UK for R100 000. Since, according to BKM's own figures, more than 50 percent of the car is imported, local production is R60 000.

The price premium afforded to local production in comparison to the UK is therefore 20 divided by 60, or 33 percent. If we assume further that the UK price for this car was 25 percent more expensive than the EU, this same car would sell for R80 000 in the EU, which means a price differential between the EU and South Africa of R40 000.

The price premium afforded local car production in comparison to the EU is therefore 67 percent. This is admittedly a rough calculation excluding, for example, any consideration of distribution costs. But it shows the orders of magnitude.

Moreover, if all or any of the following are added - lower "specs" for South African cars, obsolescence of local models and so already written-down model development costs, the non-existence of many budget cars in the country and the non-availability of certain EU/UK models here (BKM provides evidence for all of this) - the price premium paid by South African vehicle buyers increases even further.

Perhaps inadvertently, BKM have accordingly provided data that are suggestive of a very significant price premium attributable to local production paid by South African vehicle consumers in the budget segment of the car market.

What are the broader implications?

Higher prices (and the restricted choice of models) result in a reduction in consumer welfare. But more is at stake. Budget cars are often a major cost item and a significant barrier to entry for new small businesses.

In addition, budget cars are the most price-sensitive segment of the market and higher prices will have a significant negative effect on demand.

Activities downstream of car production, from repairing and panel beating to fuel provision, are very labour intensive. Car production, by contrast, is very capital intensive. The employment lost from having significantly fewer cars on the road almost certainly exceeds, probably substantially so, the employment gained from producing a few more cars locally.

The MIDP will need to be assessed in the context of government's overall economic objectives. The impact of the MIDP on local car prices and its consequent effects on business development and employment creation must remain a central concern.

David Kaplan is the Allan Gray professor of business government relations at the Graduate School of Business and department of economics, University of Cape Town

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