CATO INSTITUTE BRIEFING PAPERS

# *Will the Net Turn Car Dealers into Dinosaurs?*

## *State Limits on Auto Sales Online*

**by Solveig Singleton**

**No. 58** **July 25, 2000**

Many states have automobile franchise laws that impede or prohibit newcomers from entering the business of selling cars within certain local markets. The laws protect licensed local automobile dealers from certain types of competition; moreover, in many states those laws have the effect of prohibiting anyone except a licensed dealer from selling cars over the Internet.

Defenders of the laws assert that they are necessary to protect consumers and dealers themselves. However, those laws harm consumers by impeding competition among sellers of cars. Several economic studies, including a study by the Federal Trade Commission, support that conclusion.

In addition, state regulation of Internet commerce threatens to impede interstate commerce. The Constitution's commerce clause was intended to prevent states from erecting trade barriers that protect local businesses at the expense of national trade. The courts, therefore, will frown on states' trying to protect local dealers at the expense of consumers nationwide.

The Internet is changing the traditional relationship among manufacturers, middlemen, and consumers. The middleman will not become extinct, but consumers will interact more with manufacturers, as often manufacturers are the best source of information about a product.

Protectionist laws that make it harder to compete with traditional dealers harm consumers and will simply lead to stagnation. States should repeal laws that restrict online automobile sales before the Internet economy leaves their citizens behind.

*Solveig Singleton is director of information studies at the Cato Institute.*

**Consumers who are not happy with local dealers should not be banned from seeking alternatives to local service arrangements.**

## Introduction

> This legislation [a South Carolina law] is anti-competitive, anti-free market, and anti-consumer. It is protectionist, pro-special interest, and unconstitutional. . . . Particularly offensive to the Constitution is the portion of the Bill prohibiting car sales over the Internet, except through an authorized dealer. . . . If manufacturers in Detroit can sell cars cheaper over the Internet than dealers in Columbia or Charleston, government should stay out of the way and let them do it.
>
> —Charles Condon, attorney general, South Carolina[1]

The prospect of consumers' buying cars from Web sites has some automobile dealerships worried. To crack down on car sales online, dealership associations in Texas, Florida,[2] Wisconsin, Nebraska, Louisiana, Kentucky, Virginia,[3] Arizona, South Carolina, and Utah are urging legislators and regulators to pass new laws or reinterpret old ones.

The Internet enjoys a dizzying pace of change because most Net entrepreneurs' day-to-day business practices are unregulated. The technology enables consumers to choose from an unprecedented array of sellers and methods of salesmanship. Those choices mean that the Internet will strain to the breaking point flawed regulatory regimes in related industries (in this case, automobile distribution).

Limits on automobile sales online thus raise the decades-old question of whether protectionist measures that restrict competition in automobile sales ever benefit consumers. This paper concludes that we are not well served by restrictions on sales of automobiles online.

Times change. Conditions change. Comparative advantage changes. Regulators should not use the law to keep existing business practices and existing firms around when better practices are available.

## Car Sales Online and State Law

Automobile sales online potentially take several forms. One form, the use of a Web site by a traditional dealer to sell directly to the public, is legal; most other forms, however, are not. A car manufacturer might set up a Web site to sell cars directly to the public, bypassing dealerships. That is illegal in about 40 states, because automobile franchise laws outlaw the sale of cars directly to the public from manufacturers.[4] Those laws are general and thus not directed specifically at Internet activity; however, when the laws are restrictively interpreted, they have the effect of making the first type of Web site illegal.

A manufacturer that owns an equity interest in a dealership might use a Web site to sell to the public. Automobile manufacturers have shown an increased interest in buying dealerships. General Motors, for example, announced that it would buy 770 GM dealerships over the next decade, a plan from which it has since retreated. Ford created an "Auto Collections" arm to consolidate dealerships in Salt Lake City and Tulsa. The manufacturers' interest in dealerships stems in part from a desire to respond directly to consumer interest in options like "no-haggle" pricing and Jiffy Lube–style rapid service centers affiliated with dealerships and in part from the need to balance the power of large distributor groups like AutoNation.[5] In several states, traditional independent dealerships have responded to those developments by urging legislators to expand franchise law to further limit manufacturers' acquisition of equity interests in dealerships.[6] That indirectly affects Internet sales by preventing manufacturers from using their own dealerships to sponsor Web sites that sell cars. But carmakers like Daewoo, which owns all its own dealerships, will now enjoy an advantage over U.S. manufacturers in Internet marketing. Daewoo, both a manufacturer and a dealer, has announced plans to begin selling cars online in California.[7]

A manufacturer might set up a Web site describing the prices and the features of cars for sale but would refer customers to a local dealer to close the deal and obtain the car. Even that option is controversial. Ford established a Web site to do just that (www.fordpreowned.com). The site enables consumers to review information about used Ford cars, including the prices, and to choose a car. Ford then informs the customer of a local dealership at which the desired vehicle is available and ships the car to the dealer if necessary, and the customer picks up the car from the dealer. The dealer not only earns a fee for processing the transaction but also benefits from lower costs (due to reduced overhead for advertising, storage, and floor space) in making the sale. In Texas, state regulators ruled that, because the Web site information included the price, Ford was illegally engaged in the direct sale of cars. The state threatened Texas dealerships that had participated in Ford's program with a $10,000-per-day fine.[8] Ford shut down the Web site's service for Houston and has challenged the ruling. A new law just passed in Arizona may have similar implications for the operation of Ford's Web site service for that state.

The Internet creates the possibility of huge virtual "used car lots." Several companies that buy up a large selection of used cars and offer them for resale online to the public have formed in recent years. So far, those companies have captured only a tiny amount, less than 3 percent, of the automobile sales market. Many consumers visit the sites to learn about different models and options but ultimately buy a car by traditional means.[9] Nevertheless, this business has considerable growth potential. The companies have proven their willingness to experiment with novel business models that will be attractive to those alienated from traditional sales methods. The experiments include "haggle-free" pricing and, in one case, a controversial site designed especially for women buyers. Some virtual car lots, including Autobytel.com, CarPoint.msn.com, and Autoweb.com, operate like the Ford site in providing information but refer the customer to a dealer for a final sale. Cars.com and AutoTrader.com adopted the "classified ads" model, which helps private sellers meet private buyers. Auto.priceline.com, AutoNationDirect.com, CarsDirect.com, CarOrder.com, DriveOff.com, and Greenlight. com sell directly to consumers.[10]

Those sites are affected primarily by state licensing laws such as those in Texas, which ban the "brokering" of cars.[11] California's less restrictive law requires brokers to obtain a state license.[12] The National Association of Motor Vehicle Boards and Commissions is working on a model law for brokering online; it is expected that the new rule will have considerable impact on virtual car lots.[13]

In Texas the same regulatory ruling that closed down sales from the Ford site applied to Autoweb's virtual car lot. Like Ford, Autoweb tried to comply with the Texas law by forming relationships with dealers and referring customers to dealers. When the dealers who responded faced the regulatory threat of a $10,000-per-day fine, Autoweb changed its pricing to satisfy the regulators. Dealers now pay a flat fee for each Zip Code from which they want referrals because Autoweb may not set or suggest a price per car. DriveOff.com negotiated with regulators to obtain the same concession.[14] An unintended consequence of the regulatory deal is that rural dealers must pay far more for multiple Zip Codes to get the same number of customers as do urban lots. Jim Wolfe, vice president of marketing at Autoweb, notes that the new pricing "doesn't make good business sense" but was necessary because "we want to be in Texas."[15] Virginia has the same "flat fee" regulatory requirement.[16]

## Why Restrictions on Online Auto Sales?

The franchise laws that inhibit the new business models for car sales from spreading online are defended as being important for protecting dealers and consumers from auto-

**There's a big difference between a lemon law, which provides a remedy for a close cousin of fraud, and a law that blocks any honest deal on the Internet.**

mobile manufacturers. Defenses of those laws, which became widespread in the 1950s, revolve around two arguments: first, that restrictive franchise laws are needed to protect consumers and, second, that such laws are needed to protect distributors from rapacious manufacturers.

**Restrictions on Online Sales as Consumer Protection**

The first argument in favor of franchise and licensing laws that restrict online sales from virtual car lots or from manufacturers is that such laws protect the consumer. The local dealer, not the remote manufacturer or the Internet site, is a consumer's best chance of having a trustworthy, long-term relationship with a seller of cars. As the president of a Texas Automobile Dealers Association says, franchise laws that bar auto sales by anyone other than a franchised dealer are there for consumer protection. He offers examples of how franchise laws might serve as consumer protection:

> Over the past several years, new car dealers have helped pass legislation that outlaws and punishes fraud and questionable practices in the automotive industry. . . . They have assumed the responsibility to provide . . . a guarantee to every vehicle title sold, a guarantee that the odometer has not been rolled back, disclosures of vehicle history . . . and a . . . "lemon law." . . . The new car dealers have the responsibility to process all the required paperwork and collect taxes and fees for the state.[17]

**It is likely that the Internet will diminish the number of middlemen, such as real estate agents, travel agents, or car dealers.**

The dealer's ability to offer a local service relationship to a customer is certainly one of the dealer's strongest selling points and may be part of the reason that car sales are slow on many Web sites, as many consumers go there to learn but buy from traditional dealers. One consumer who had bought a car from a Web site was alarmed to discover that, upon arrival of the car, the radio and some of the switches did not work.[18] Interestingly, the Web site had anticipated such problems and arranged with a local dealer to service the car. Perhaps the market will inexorably demand guarantees of a long-term local service relationship or opportunities to test-drive and smell the new car. In response, Internet dealers would be likely to seek partnerships with real-world car lots.

However, consumers who are not happy with local dealers should not be banned from seeking alternatives to local service arrangements. Consumers seem to prefer choice to paternalism; surveys show that from 60 to 70 percent of consumers object to legislative actions restricting online car sales.[19] Even traditional consumer groups, generally not known for supporting deregulation, are concerned that franchise laws that restrict online sales do not serve consumers.[20]

Consumers' interest in reliable local service suggests that they would also have a strong interest in dealerships that provide fast and honest service. Franchise laws have impeded the evolution of such dealerships. It would have been logical, for example, for dealerships to have been the first to offer fast, inexpensive routine maintenance, but Jiffy Lube and its competitors beat them to the punch. A type of franchise law known as a Relevant Market Area law[21] prevents dealers from pursuing the option first, because RMA laws give dealers within one local market the power to oppose "disruptive" innovations such as service centers put forward by other dealers.

Laws that "protect" the consumer are likely to do more harm than good when they restrict competition. There's a big difference between a lemon law, which provides a remedy for a close cousin of fraud, and a law that blocks for certain sellers any honest deal on the Internet from going through. The first law does not restrict competition in any meaningful way, but a law that prevents new outlets for car sales from opening on the Internet certainly does. From the consumers' standpoint, restrictions on Internet auto sales look like another way to deny them choice and cost savings.[22] In the words of one citizen:

> I was disappointed that the Texas Board of Motor Vehicles and the automobile dealer associations have seen fit to build a wall around Texans so they cannot buy cars over the Internet. . . . I bought a pre-owned Ranger pick-up over the Internet from Ford Motor Co. It was, without a doubt, the most convenient way to buy a car I have ever experienced. . . . State regulators are representing only their own interests, not the taxpayers![23]

As I discuss in the sections below, several economic studies show that the anti-competitive impact of franchise laws has the effect of raising car prices for consumers.

### Restrictions on Online Sales as Dealership Protection

The second argument in favor of franchise laws that restrict competition with local dealers is that such laws are necessary to protect dealers from manufacturers. Several goals underlie that argument. One goal, already addressed, is to protect consumers; another goal is to protect jobs. A related argument might be that preserving dealerships is a good in itself—that businesses have a "right" to remain in business, even if market conditions change.

The danger to dealerships posed by a manufacturer's using the Internet to compete with its own dealers is speculative. Ford's Web site program had many willing dealer-participants who benefited from the arrangement. Automobile manufacturers' power today is checked by foreign competition and by powerful national chains of dealers like AutoNation, which owns over 400 dealerships around the country.[24] State regulatory surveys have found little evidence that manufacturers would "abuse" dealers. The manufacturers continue to rely on the dealer model to maximize the seller's incentives to enthusiastically distribute their cars and therefore need to preserve their reputation as reliable business partners. Even if manufacturers did stretch their rights under the franchise agreements, the remedy need not restrict competition by creating entry barriers to new dealers.[25]

More important, however, is the issue of whether a change in business practices such as more online competition in automobile sales should be held back by regulation, even if that change does have an impact on some dealerships (and therefore on jobs). It is likely that the Internet will in the long run diminish the number of middlemen, such as real estate agents, travel agents, or car dealers.[26] It is not written in the sky that one may buy bread from a baker, or a house from a builder, but may not buy a car from someone other than a local middleman-dealer. Economists and the Supreme Court have long rejected the view that vertical integration is per se harmful from an antitrust standpoint; indeed, vertical integration can bring important efficiency gains that are passed on to consumers. There is no reason to suppose that the business models for distributing cars should remain as they were in the early part of the 20th century. Car dealerships do not "own" their customers; those customers have a right to buy elsewhere if they so choose. Similarly, employees do not have a right to demand that they keep a particular job at consumers' expense.

Laws that protect businesses from upstarts' raids on "their" customer base are not good for consumers. Such laws have the effect of restricting competition and raising prices. Dealers admit that they fear Internet competition because online distributors, by bypassing the dealers, incur lower costs, which can mean savings for consumers. Two private studies[27] and an FTC study[28] found that automobile franchise laws that allow dealers to object to the location of a new dealer in their area—the RMA laws—mean higher prices for consumers. (A critique of the FTC study by Wharton Econometric Forecasting Associates failed to adequately rebut the FTC's findings.)[29] Limitations on auto sales

**Car dealerships do not "own" their customers; those customers have a right to buy elsewhere if they so choose.**

online would also probably mean higher prices for consumers.

From an economist's standpoint, because franchise laws restrict competition, they look suspiciously like rent seeking[30] resulting from "regulatory capture." Regulatory capture happens because regulated business entities develop long-term cooperative relationships with their regulators. In endless debates and meetings, the regulated entities ultimately persuade well-meaning regulators that restraints on competition are in the public interest.

Many automobile regulators seem unable to question that the public's interest lies with protecting the dealers—and keeping the existing regulations as strong as possible. Carol Kent of the Texas Motor Vehicle Division noted, "If the car dealer isn't there, somebody from Midland could have to drive all the way to Dallas to get their warranty work done."[31] But that is a very strange argument. The rise of service centers like Jiffy Lube shows that free markets respond to customers' need for service. Consumers already prefer to use independent service centers for repairs not under warranty, because their prices are often lower than the dealers' prices. There's no reason consumers *need* to have warranty work done by dealers, *except* that some state laws and regulations make it illegal for anyone but a dealer to offer warranty work. A number of states prohibit manufacturers from operating their own service centers. If there is a shortage of warranty service outlets, it would appear to be the result of regulation, not competition from the Internet.

**The most successful businesses will respond to market forces quickly, not use legal barriers to turn themselves into dinosaurs.**

By contrast, the FTC, as well as the auditors and attorneys general of several states—who had not been part of a long-term relationship with dealer associations that would lead to "capture"—take the view that competition would benefit consumers more than would RMA laws, which restrict the opening of new local sales outlets for cars.[32] Given the findings of those state auditors and attorneys general,[33] government support for restricting online auto sales to local dealers seems unlikely[34]—except, oddly, from the state regulators and legislators enjoying the closest relationship with automobile dealers' associations.

## The Future of Automobile Dealerships: Some Hard Lessons

The lessons of automobile history from the early 1980s support the conclusion that neither dealers nor consumers will benefit from laws "protecting" dealers. U.S. car manufacturers and the United Auto Workers, by successfully urging policymakers to adopt quotas for the import of Japanese cars, imposed enormous costs on American consumers. At the time, Brookings Institution economist Robert Crandall estimated that Japanese cars were priced almost $1,000 higher than they would have been without quotas, while prices on American cars went up about $400;[35] that adds up to billions of dollars in costs imposed on consumers as a result of protectionism.

The end of protection from foreign competition did not mean the end of U.S. car manufacturers. Enhanced competition was probably the best thing not only for consumers but for the manufacturers too. Competition meant innovation, cost cutting, and renewed reliability.[36] In addition, protection always has unintended consequences for the "protected" manufacturers themselves. Consumer demand for Japanese products was too strong to thwart, and Japanese companies enjoyed healthy profits. The only result of the quotas was that, instead of exporting many cheap cars, the Japanese began to export fewer luxury cars. One way or another, the forces of the market made themselves known. When General Motors tried to respond to the demand for Japanese cars by importing them to sell under its own label, the import quotas got in General Motors' way.[37] The lesson of the 1980s is that protectionism helps neither consumers nor the "protected" industry. We should not repeat the history of the 1980s on a state-by-state basis.

The most successful businesses will be those that respond to market forces most quickly, not those that use legal barriers to turn themselves into dinosaurs. Tom Siebel of Siebel Systems describes how the Internet will radically change the management of the chain of distribution among manufacturers, consumers, and middlemen across the entire economy.[38] Consumers, knowing that manufacturers have the answers they want, will seek direct contact with them; in response, manufacturers will develop new consumer service functions. Middlemen will continue to play a role, albeit a changed one, in distribution. Sometimes the middlemen will be bypassed, but for the most part they will continue to serve both consumers and manufacturers. The Internet will lead consumers to expect interactivity—if manufacturers fail to respond to consumers' direct questions, consumers will be angry and frustrated. Any middleman who tries to stop the consumer from getting the answer he wants is likely to be left far behind.

Automobile dealers who learn to compete aggressively in the new marketplace by selling their strengths—their ability to offer consumers a long-term local relationship and the test-drive experience, with or without the Internet—will do best. Future generations will expect to use the Internet for "legwork" and will venture out of their houses only when they have narrowed their choices to one or two stereos or couches or cribs or cars—and they will not expect state borders to get in their way. Dealerships cannot hope to resist the tide of change that is transforming the entire economy.

## Car Sales Online and the Constitution

Restrictive automobile franchise and state licensing laws that result in de facto bans on auto sales online face constitutional challenges in the courts. Under free speech and commerce clause arguments, the laws' prospects are dim.

Florida legislators are considering a bill backed by the Department of Highway Safety and Motor Vehicles that would restrict auto manufacturers' advertising online.[39] That restriction violates First Amendment rights of free speech. Over the years, the Supreme Court has moved toward greater protection of commercial speech, emphasizing that it is yet another form of truthful speech.[40] Restrictions on price advertising are particularly suspect, because they harm consumers by depriving them of price information and therefore of the benefits of vigorous price competition.[41] As laws restricting the distribution of information about a lawful product, state bans on automobile advertising online by nontraditional dealers do not stand a chance in court. Although it technically regulates the activity of selling and not speech per se, the Texas ruling that the Ford Web site was "selling" cars because it included price information is constitutionally suspect.

The impact of restrictive state licensing and franchise laws on the sales of automobiles online will have an effect on interstate commerce by tending to shield the dealerships based in a given state from out-of-state competitors. The purpose of the Constitution's commerce clause, which regulates interstate commerce, is to prevent impediments to the free flow of commerce among states.[42] Courts recognize that state laws that discriminate against out-of-state products or that destroy the unity of a national market to reap local benefits are unconstitutional. That doctrine is known as the "dormant commerce clause."[43] Laws that tend to restrict would-be national automobile sellers to benefit in-state dealerships raise serious constitutional issues because those laws delay and prevent national competition for purely local benefits.[44] Courts have recognized that state regulation of the Internet is especially problematic under the dormant commerce clause.[45]

The clause enables states to use traditional state police powers to pursue legitimate goals such as health and safety, even if the regulations impede interstate commerce. But

**Laws that tend to restrict would-be national automobile sellers to benefit in-state dealerships raise serious constitutional issues.**

economic protectionism is not considered a legitimate goal; it is precisely what the commerce clause was intended to prevent.[46] There is no strong health, safety, or consumer protection argument for restricting automobile sales online.

Few state franchise laws explicitly discriminate against out-of-state dealers—that is simply the laws' effect. (Some states do explicitly discriminate.)[47] Dormant commerce clause cases generally do not allow for discrimination (especially if the purpose of the law is protectionism)—unless the burden is incidental. As one court put it, a law that affects interstate commerce only indirectly is still invalid when "the burdens it imposes on interstate commerce are excessive in relation to the local benefit it confers."[48] The burden is far from incidental, however, in the case of franchise and licensing laws that, as in Texas, cause would-be competitors to shut down Web sites or stay out of the market entirely.

**State franchise and licensing laws violate the commerce clause of the Constitution, which was intended to prevent the protection of local markets at the expense of national competition.**

Consistent with that reasoning, Condon considers unconstitutional a bill passed by the South Carolina House of Representatives that seeks to prohibit anyone from selling cars over the Internet except through local dealers. The statute provided that "a manufacturer or franchisor may not sell, directly or indirectly, a motor vehicle to a consumer in this State, except through a new motor vehicle dealer holding a franchise for the line that includes the motor vehicle"; another section provided that "[t]his chapter does not prohibit a dealership located in this State from contracting with an on-line electronic service to provide motor vehicles to consumers in this State."[49] The attorney general, citing *American Library Association v. Pataki* and *Cyberspace Communications v. Engler*, explained that "certainly the Internet portion of the Bill would undoubtedly be struck down by a court as violating the commerce clause. Other portions of the Bill, particularly the provision prohibiting a manufacturer or franchisor from operating a dealership, would likely also fall as discriminating against interstate commerce."[50] He concluded that the bill was "patently unconstitutional."

## Conclusion

State franchise and licensing laws that impede or block the operations of auto sales online harm consumers by restricting competition. The laws have a particularly burdensome impact on national or out-of-state would-be competitors in the auto sales business. The laws therefore violate the commerce clause of the Constitution, which was intended to prevent the protection of local markets at the expense of national competition.

Consumers will expect to use electronic information networks to educate themselves, narrow their options, and sometimes, to conclude a sale.[51] That will not eliminate the automobile dealership; dealers have too much to offer in terms of local service. In the long run, automobile dealers will not benefit from protectionism; dealers that adapt to the new networks will do best.

Manufacturers of buggy whips would not have been saved for long by laws restricting the sale of cars; in the vast distances of the North American continent, the need for faster, cheaper means of transportation created an irresistible demand for automobiles. In a world of rush-hour traffic and a bewildering array of choices, online information and sales options are the wave of the future.

## Notes

1. Charles Condon, Letter to the Honorable W. Greg Ryberg, State Senator, District no. 24, April 5, 2000, p. 4. Cited hereinafter as "Condon Letter."

2. Patrick Danner, "Right of Way Fight: State Law Bans Carmakers from Selling Directly to Public, but Consumers and Manufacturers Want Change," *Broward Daily Business Review,* March 24, 2000, p. A12.

3. Keith Bradsher, "Car Dealers' Driveway Blues: Pushing for a Crackdown on Sales Done Directly Online," *New York Times,* January 25, 2000, p. C1.

4. Danner, p. A12.

5. For a description of the need for manufactur-

ers to respond to AutoNation, see ibid.

6. For a description of Florida bills backed by South Florida Auto-Truck Dealer Association, see ibid.; see also *An Act Amending Section 28-2097 and 28-4301, Arizona Revised Statutes*, H.R. 2101, 44th Legislature, 2d sess. 2000, § 28-4460 B(1)(b); and *Motor Vehicle Franchise Amendments: 2000 General Session State of Utah*, H.R. 113, § 13-14-201 (u), (w).

7. John O'Dell, "Daewoo Steering Car Sales to the Internet," *Los Angeles Times*, February 2, 1999, p. C2.

8. "No to Excessive Regulation: Threat to E-Commerce Coincides with Advisory Commission Meeting in Texas," PR Newswire, March 20, 2000.

9. A J. D. Power & Associates survey shows that nearly 50 percent of new car buyers do their research online but that only 2.7 percent buy from the Internet. See Bradsher, p. C1.

10. Bruce Ramsey, "Lots Are Looking, but Few Buy Online—So Far," *Seattle Post-Intelligencer*, February 4, 2000, p. B1.

11. For the impact of Texas law on CarDirect.com, Ford.com, carOrder.com, and other sellers, see Jennifer Montgomery, "Dot-Competition Bypasses Texas: Dealer-Protection Rules Prohibit Direct Auto Sales over Internet," *Houston Chronicle*, March 19, 2000, p. B1.

12. Donna Harris, "Texas Oks Rules for Net Services," *Automotive News*, February 14, 2000, p. 1.

13. Ibid.

14. David Koenig, "Internet Car Dealers Finally Getting Approval to Operate in Texas," Associated Press, February 10, 2000, electronic version.

15. Quoted in Montgomery, p. B1.

16. Maria Howard, "Buyers Still Can't Kick the Tires Online," *Richmond Times Dispatch*, p. F1.

17. Gene Fondren, "The Real E-Deal: Good Reason for Limits on Used Car Sales on Internet," *Houston Chronicle*, March 26, 2000, p. 1.

18. Chris Knap, "Almost Auto-matic: Internet Firms Are Increasingly Tapping into the Market of Vehicle Purchases," *Orange County Register*, September 20, 1999, p. C12.

19. A Telesurveys Research Associates survey showed that 67 percent of Texans surveyed opposed the regulatory decision that closed down Ford's Web site. See "No to Excessive Regulation." An Opinion Research International survey reported that 71 percent of consumers nationwide did not support Texas regulators' actions in closing the site.

20. The involvement of Consumer Federation of America and the Florida Public Interest Research Group in opposing Florida law restricting online auto sales is described in Danner, p. A12. According to Jack Gillis of Consumer Federation of America, "We do have some serious concerns right now that dealers are using old franchise laws to inhibit new and creative ways to sell cars, and most of these new and creative ways are in consumers' interest." Quoted in Bradsher, p. C1.

21. See, generally, American Bar Association, Antitrust Section, "Franchise Protection: Law against Termination and the Establishment of Additional Franchises," Monograph no. 17 (n.p.: ABA, 1990), pp. 71–116. Cited hereinafter as Monograph no. 17.

22. A consumer interested in buying directly from the manufacturer stated: "I feel I'm getting a better price because I'm buying from the manufacturer on his lot. . . . I'm basically not paying the cost of distribution." Quoted in Danner, p. A12.

23. Larry Carnes, Letter to the Editor, *Houston Chronicle*, March 23, 2000, p. A35.

24. Danner, p. A12.

25. In 1956 Congress passed the *Federal Automobile Dealer Franchise Act*, which allows dealers to sue in federal court for damages caused by an auto manufacturer's failure to act in good faith in terminating a dealership. 15 U.S.C. §§ 1221–25.

26. See Robert E. Litan and William A. Niskanen, *Going Digital! A Guide to Policy in the Digital Age* (Washington: Brookings Institution Press and Cato Institute, 1998).

27. E. W. Eckard Jr., "The Effects of State Automobile Dealer Entry Regulation on New Car Prices," *Economic Inquiry* 24 (April 1985): 223–42; and Richard L. Smith II, "Franchise Regulation: An Economic Analysis of State Restrictions on Automobile Distribution," *Journal of Law and Economics* 25 (April 1982): 125–242. These studies have been criticized on various grounds. But a report by the FTC's Bureau of Economics found that the Smith and the Eckard studies likely *under*estimated the impact of RMA laws on prices: "Our analysis . . . suggests that the costs of [RMA laws] are much higher than previously estimated [by Smith and Eckard]."

28. Robert P. Rogers, "The Effect of State Entry Regulation on Retail Automobile Markets,"

Bureau of Economics staff report to the FTC, January 1986, p. 12.

29. See Wharton Econometric Forecasting Associates, Inc., "An Evaluation of the FTC's Analysis of the Effects of RMA Laws on Auto Markets," Philadelphia, Pennsylvania, January 1987. The FTC issued a revised version of its findings following the WEFA critique and corrected for those arguments in the critique that the FTC considered valid. The FTC's reanalysis reached the same conclusion as did the original study—that franchise laws raised car prices. See Federal Trade Commission, Bureau of Competition, Consumer Protection, and Economics, "Response to Wharton Econometric Forecasting Associates' Comments on the Bureau of Economics Study of Relevant Market Area Laws," p. 153, reprinted in Monograph no. 17, pp. 145–61.

Two WEFA arguments were, first, that franchise laws might increase the quality of service for consumers even if they also raised the price and, second, that the FTC study did not take account of varying dealer costs. The first argument is dubious—laws that restrict competition generally would not improve quality of service. The Wharton study cites no evidence that franchise laws have done so. A "benefit" foisted on consumers by regulation is a dubious benefit; the consumer might have preferred buying a new winter coat or a new water heater to paying a higher price for a car plus extras mandated by regulation. The second argument, concerning dealer costs, is likewise not relevant. The FTC's response notes that there is no reason to suppose that factors contributing to dealer costs vary depending on whether franchise laws are in place. Federal Trade Commission, "Response to Wharton Econometric Forecasting Associates' Comments," p. 150. If anything, the FTC's approach would lead to an *under*estimation of the impact of franchise laws on price—that is, dealer costs are not fixed. Competition includes pressure to bring costs, not just prices, down. So franchise laws that restrict competition are likely to raise costs as well as prices. If dealer costs *were* systematically higher in states with franchise laws, that would likely be an effect of the law and part of the reason, not an excuse, for higher prices.

30. Noting the social costs of rent seeking in discussing RMA laws, see Rogers, p. 9 n. 7.

31. Quoted in Montgomery, p. B1.

32. Auto dealers argue that the evidence shows that the opening of a new dealership is blocked in only about 82 percent of all cases. Still, that leaves an entry barrier keeping out about 15 percent of new entrants—not an insignificant impact. And the figure for new dealerships that are rejected by regulators is deceptively low—the expense, delay, and risk the RMA laws bring to a potential new dealer's economic situation will deter some from even initiating the process. See Federal Trade Commission, "Response to Wharton Econometric Forecasting Associates' Comments," p. 147.

33. See Monograph no. 17, p. 91; State of Florida, Office of the Florida 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 31, February 19, 1986; Ohio Attorney General's Comments on Ohio S.B. no. 206, September 1979; State of Tennessee, Comptroller of the Treasury, Performance Audit of the Tennessee Motor Vehicle Commission, March 1986 (concurred by the Tennessee Department of Commerce and Insurance); and Office of Program Policy Analysis and Government Accountability (Florida Legislature), Review of the Automobile Manufacturer Licensing Program, p. 7 n. 8, February 26, 1996 (also citing Hawaii and Texas auditors' reports).

34. "Condon Letter," pp. 2–5 (concluding that restrictive franchise law that would have the effect of closing car manufacturers' existing dealerships would constitute unconstitutional "takings" under the due process clause, would tend to create "limited monopolies, would exclude otherwise qualified persons from obtaining dealerships and would interfere with the right of manufacturers to establish additional dealerships for their cars").

35. Robert W. Crandall, "Import Quotas and the Automobile Industry: The Costs of Protectionism," *Brookings Review* 2, no. 4 (Summer 1984): 8–13. Estimates vary; another estimate put the cost to consumers at $2.7 billion in 1983. See "Scrap the Auto Restraints," *Chicago Tribune*, January 1, 1985, p. C14.

36. Richard I. Kirkland Jr., "America on Top Again," *Fortune*, April 15, 1985, p. 134, reported that U.S. automakers slashed production costs by 34 percent to compete with Japan.

37. P. Rajan Varadarajan, Terry Clark, and William M. Pride, "Controlling the Uncontrollable: Managing Your Market Environment," *Sloan Management Review* 33, no. 2 (January 1992): 39.

38. Tom Siebel, "Demand Chain Management: E-Business Channel Dynamics," Remarks at the Annual Cato Institute–Forbes ASAP Conference: "Technology and Society 1999," Milpitas, California, November 4–5, 1999.

39. Danner, p. A12.

40. See *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748 (1976); and *Central Hudson v. Public Service Comm'n*, 447 U.S. 557 (1980). Central Hudson established the following inquiry to test the constitutionality of a restriction on commercial speech:

(a) Does the speech accurately promote a legal product or activity?
(b) Is the government's interest in regulating the speech substantial?
(c) Does the regulation directly advance the government interest at issue?
(d) Is there a reasonable fit between the regulation and the interest it is intended to further?

41. See *Liquormart 44 v. Rhode Island*, 517 U.S. 484, 497–98 (1996) (abandoning *Posadas* case) (*Posadas de Puerto Rico Assocs. v. Tourism Co.*, 478 U.S. 328 [1986]).

42. Roger Pilon, "A Modest Proposal on 'Must-Carry,' the 1992 Cable Act, and Regulation Generally: Go Back to Basics," *Hastings Communications and Entertainment Law Journal* 17 (1994): 41.

43. See, generally, Lawrence H. Tribe, *American Constitutional Law* (Mineola, N.Y.: Foundation Press, 1988), § 6-3.

44. Dan L. Burk, "How State Regulation of the Internet Violates the Commerce Clause," *Cato Journal* 17, no. 2 (Fall 1997): 153.

45. See *American Library Association v. Pataki*, 969 F.Supp. 160 (S.D.N.Y. 1997) (finding that New York law regulating speech considered "harmful to minors" on the Internet violates the commerce clause); and *Cyberspace v. Engler*, 55 F.Supp. 2d 737 (D.C.Mich. 1999) (striking down Michigan law regulating the distribution of obscene speech online to children).

46. See, for example, *People v. Foley*, 257 A.D.2d 243, 256 (N.Y. App. 1999) (finding that a law with the primary purpose of protecting children does not violate the commerce clause when "[t]he statute is not an economic protectionist measure, but rather is directed at a legitimate local concern," ibid. at 256).

47. For example, in Virginia the law allows car sales only by licensed dealers, and a dealer can obtain a license only if a "substantial" part of his sales are in Virginia. Howard, p. F1.

48. *American Library Association* at 177.

49. A South Carolina bill to *Prohibit Ownership, Operation, or Control of Competing Dealerships by a Manufacturer or Franchisor except under Certain Circumstances*, H.R. 445, 113th sess. 1999; bill text enacted May 17, 2000.

50. "Condon Letter," pp. 2–3.

51. In 1999, 40 percent of car buyers used the Internet to research purchases, dealers, and prices; J. D. Power and Associates predicts that the figure will rise to 66 percent. Montgomery, p. B1.

Published by the Cato Institute, Cato Briefing Papers is a regular series evaluating government policies and offering proposals for reform. Nothing in Cato Briefing Papers should be construed as necessarily reflecting the views of the Cato Institute or as an attempt to aid or hinder the passage of any bill before Congress. Additional copies of Cato Briefing Papers are $2.00 each ($1.00 in bulk). To order, or for a complete listing of available studies, write the Cato Institute, 1000 Massachusetts Avenue, N.W., Washington, D.C. 20001, call (202) 842-0200 or fax (202) 842-3490. Contact the Cato Institute for reprint permission.