

# The growth in the chinese automobile industry economics essay

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Literature ReviewDeng et al. (2010) have argued that large manufacturers set high markups, which proves their strong market value in China's automobile market. Their decreasing markups in the late 1990's determine a reduction in market control by the major producers. Through a combination of trade barriers such as tariffs and quotas set by the central government and lower license fees for Shanghai made vehicles established by the local government, Shanghai Volkswagen succeeded in capturing 41 per cent of the market share and setting premium prices with markups of 42 per cent. The average markup for the Chinese automobile market inferred by the study is relatively high as compared to the U. S automobile market. The results show a decline in markups toward the end of the sample period. The increase in competition from the entrance of new car manufacturers in addition to the decline in government restrictions coincided with the guidelines laid out for China's accession to the World Trade Organization in 2001. In the literature it is determined that decreased automobile prices have a positive impact upon the buying behavior of consumer. A research upon China automobile market has been done to illustrate the statement, which clearly identifies the role of prices and the government factors involved in making the China's automobile industry their core business. The tremendous growth in the Chinese automobile industry over the last two decades is largely associated to market interventions by the Chinese government in an effort to develop its main industry. The major automakers have benefited from the infant industry protection which enabled them to set high markups, particularly in the case of Shanghai Volkswagen, who received additional local protection. Declining markups toward the end of the sample

period coincides with lowered industry barriers and increased competition from new domestic firms and the entry of additional foreign firms. The use of tariffs and quotas would be justified if the restrictions allowed the Chinese automakers to decrease their future costs such that protection was no longer necessary. There is some evidence that the industry is heading in this direction as the tariff, although non zero at 25 per cent, has dropped substantially from the high point of 100 per cent. Moreover, some producers have achieved lower average costs as they began to target the global market through exports. The consumers in Shanghai and surrounding areas bore additional costs due to the local protection granted to Shanghai Volkswagen. The cost to these consumers consisted of outdated models and high markups that reached 42 per cent. The estimates suggest that these markups decreased over time as competition intensified due to the proliferation new domestic entrants and the reduction in non tariff barriers in accordance with World Trade Organization guidelines. As prices of domestic cars continue to drop, consumers may eventually see the benefit of the severe restrictions imposed during the growth of this infant industry. U. S government has imposed corporate average fuel economy (CAFE) regulations on manufacturers for their vehicles sold in the United States. If these standards run contrary to consumer preferences or when technology advances fail to deliver anticipated benefits, automobile manufacturers may use price as a short term strategy to encourage consumers to switch to vehicles that help the firm to achieve fleet wide compliance, Biller et al. (2006). The literature estimates the impact of increasingly tight environmental standards on profits. Prices and production for 20 vehicles

with large volumes were optimized for a specific CAFE target to estimate the efficient frontier of profits. The findings illustrates, if the CAFE standards tighten, profit based on price changes alone decreases substantially. Result suggests that tighter fuel regulations will require more attempts to manage demand and manufacturers will also need considerable technological improvements. Indeed, automobile manufacturers are planning technology improvements that will enable them to meet the fuel regulations. For example, General Motors is trying to eliminate the environmental impact of its vehicle fleet by introducing fuel-cell-powered vehicles. Furthermore, GM and other manufacturers have been developing hybrid pickup trucks, and hybrid SUVs. Although if technologies fail to deliver the expected improvements or when customer demand shifts towards less fuel-efficient vehicles, manufacturers can use price to improve compliance and can coordinate price with production decisions to improve efficiency, profitability and environmental friendliness. The primitives to be estimated are parameters describing the firm's marginal costs and the distribution of consumer tastes which determines elasticities and these together with marginal cost and a Nash assumption, determine equilibrium prices, Berry et al. (1995). Consumer preferences are explicitly aggregated into a market level demand system that is afterwards combined with an assumption on cost functions and on pricing behavior to generate equilibrium prices and quantities. The literature determines the effect of consumer preferences upon the estimation strategy which involves solving an aggregation problem in moving from individual to aggregate demands and solving a nonlinear simultaneous equations problem to account for endogenous prices. These

techniques have precursors in the literature. It explains how to use widely available data on the distribution of consumer characteristics to augment market level information and also the use of recent results to describe and compute an approximation to the efficient instrumental variables. the framework is based upon, 1. A joint distribution of consumer characteristics and product attributes that determines preferences over the products marketed, 2. Price taking assumptions on the part of consumers and 3. Nash equilibrium assumptions on the part of producers.