

Participation Application

The revival of incentives for automobiles demonstrates all of the major themes of microeconomics from trade-offs to prices and markets. In a market economy, prices are determined by the interaction of consumers, firms, and workers. These interactions form the basis of the market where buyers and sellers gather together for transactions. The auto industry offers a well known example of price determination and market interactions through competition. The major automakers such as Ford, General Motors, and others must now compete not only on vehicle specifications but also on incentives on their products. The auto market represents a highly competitive market despite its relatively low number of producers. The major auto makers are forced to compete fiercely for market share against established firms and new entrants as America shifts to a new equilibrium for its fuel economy. The rapid fluctuations between car offers and incentives over the months reflects the continuing competitiveness of the market from decisions based on trade-offs and opportunity costs. The auto industry faces the restraint of trade-offs from rising oil prices and interest rates. The firms face limits on product output and the resources viability. Many of the major auto firms are well equipped to produce fuel inefficient vehicles such as SUVs and trucks but are not very good at producing new fuel efficient cars. Firms incur opportunity costs from its potential profits of selling fuel efficient cars instead of offering its current vehicles with incentives. The major auto companies however choose to focus its resources on mass producing fuel inefficient vehicles at discount. The firm thus maximizes its profits and resource usage given its restraints. The consumers also face trade-offs and limitations in their allocations of resources. Consumers have limited income and thus must make decisions for utility maximizations in their product choices. The utility between free gas back offers for SUVs or greater long- term fuel efficiency of hybrids has now become an

increasing trade-off decisions in recent months. Consumers maximize their resources through purchases that balance preference, utility, and opportunity costs. Car buyers make decisions on whether to accept current offers from the major auto retailers or new fuel efficient car offers from new auto industry entrants. The sales and resale growth of fuel-efficient and hybrid vehicles means greater opportunities for economical profits and incentives for new auto makers to enter this sector of the auto industry. Established firms have reacted to consumer and competitors choices for future product decisions and offer incentive packages in order to gain back market share. The sellers' competitive offers of incentives and discounts demonstrate their factor in price determination against their competitors. Buyers have shifted preferences towards auto choices in response to price changes from the sell side of the oil market. The auto market seller side must then react through new marketing schemes or new production shifts. The cycle of consumer and seller reactions and interactions thus determine prices between this gathering of buyers and sellers in the market. The auto market is thus its own micro-economy with buyers and sellers trying to maximize their benefits against their costs.

Car Industry Brings Back Incentives

To Counter High Fuel Prices, Rising Interest Rates, Dealers Offer As Much as \$6,000 in Rebates or Gas

By GINA CHON May 2, 2006; Page D1

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With high gasoline prices and rising interest rates weighing on consumers, car dealers and auto makers are reviving a range of buying incentives.

Some car dealers are bringing back free-gas offers that were popular last year as gasoline reached \$3 a gallon following Hurricane Katrina, and this time many are sweetening the offers. One California dealer this week began offering customers a choice between cash rebates of thousands of dollars or up to \$6,000 of free gas when purchasing certain vehicles. And zero-percent financing is once again a popular promotion among car makers looking to pare inventory of older models.

At the same time, there is some evidence that gas prices may be reaching a level that is changing some consumer's vehicle preferences.

"Everybody is concerned about fuel economy," says Lou Lombardi, general manager of the Linden Dodge and Linden Volkswagen dealerships in Linden, N.J. "Customers are trading SUVs in for something less of a gas guzzler."

Rowina Zenzal of Santa Barbara, Calif., bought a 2006 Nissan Armada SUV four months ago, but decided to put it up for sale a week ago. She says she couldn't afford to keep the vehicle because of high gas prices, which have reached \$3.50 a gallon in her area. The SUV, with only 4,000 miles on it, is selling for \$33,500, about \$5,000 less than what she paid for it. "It was costing us \$80 to fill the tank," Ms. Zenzal says. "Now we are looking to buy a used Honda Accord or Civic. Something that won't cost so much to fill up."

Last summer, car sales hit record levels because of employee-discount programs offered by [General Motors](#) Corp., [Ford Motor](#) Co. and Daimler-Chrysler AG's Chrysler Group. Since then, auto makers have been trying to wean customers off such large incentive programs, and have opted for traditional cash rebates to bring consumers into showrooms.

FINANCING DEALS

Some of the incentive programs from car makers:

- **Ford** is offering zero-percent financing on Milan Monterey, Ford Ranger and Ford Freestar.
- **Chrysler** is bringing back zero-percent financing for most models.
- **GM** is offering zero-percent loans for 2006 models of Cadillac Escalade, Chevrolet Tahoe and GMC Yukon.

GM, which posted a loss of \$10.6 billion last year, has revamped its pricing strategy to rely less on incentives, which would boost profitability on its vehicles. For its March Madness program, GM offered a relatively small incentive: \$500 to \$1,500 cash back, which failed to lure many

buyers. On the other hand, Chrysler has been offering \$1,000 to \$5,000 cash back, which has drawn more buyers. Auto makers will report April sales figures today.

Many of Ford's national zero-percent offers ended yesterday, but a number of dealers are continuing the promotions in various regions. For May, Ford is continuing its zero-percent offers for the Freestar and Ranger, while Mercury is offering a similar incentive for the Monterey. For its popular F-150 truck, Ford is offering a \$3,500 cash rebate.

At Future Ford in Sacramento, Calif., customers can choose between cash rebates or free gas when purchasing certain vehicles. For example, there is a \$6,000 rebate offered for an Expedition sport-utility vehicle but customers, starting last Friday, were able to choose between the cash or \$6,000 of free gas.

Chrysler said it is bringing back zero-percent financing for up to 60 months on most models. Customers can choose between the zero-percent offer or the cash-back offers that have been available since the start of April. Chrysler had been offering zero-percent promotions earlier this year until it switched to cash-rebate offers in April.

Terry D'Arcy, who owns dealerships for Pontiac-Buick-GMC, Hyundai and Volkswagen in the Joliet, Ill., area, says he offered \$500 gas cards last year when prices increased at the pump. But this year, he says he will have to try even harder to lure customers, so he might give away \$1,000 in gas.

Gas prices, which recently topped \$3 per gallon on the West Coast and even hit \$4 a gallon in a few areas, like Beverly Hills, Calif., are expected to keep climbing through the summer due to the high price of crude oil and shortages at refineries. Auto makers have included the number of vehicles that get at least 30 miles per gallon in their advertisements, and both Ford and Chrysler have issued fuel-saving tips.

Auto makers also have been investing more in producing crossover vehicles, which are small SUVs that are more fuel-efficient because they are lighter than traditional SUVs. [Toyota Motor Corp.](#) and [Honda Motor Co.](#) have also come out with small subcompact vehicles, the Yaris and the Fit, which both get more than 30 miles per gallon in the city.

A survey released last Wednesday showed 62% of new-car buyers said they were strongly considering purchasing a vehicle they would normally not consider because of high gas prices. The study by Harris Interactive and Kelley Blue Book also showed consideration for compact sedans were at an all-time high of 19%.

Last September, [Mitsubishi Motors Corp.](#) was one of the first auto makers to kick off a free-gas campaign, giving away prepaid debit cards ranging from \$1,500 to \$2,500. Chrysler followed in November with the Miles of Freedom program, which offered two years of free gas. Both Mitsubishi and Chrysler say they have no immediate plans to offer similar promotions this year.

Rising interest rates also are a concern for car buyers, prompting several dealers to offer zero-percent financing offers. Ford dealers, for instance, are offering zero-percent promotions in parts

of the country through July 5. Many Lincoln dealers are offering zero-percent financing for 2006 Lincoln LS sedan, 2006 Navigator SUV and 2006 Town Car sedan in Boston, New York, Philadelphia and other cities, according to consumer auto Web site Edmunds.com. Nationwide through July 5, consumers interested in a 2006 Cadillac Escalade, 2006 Chevrolet Suburban or 2006 GMC Yukon can get zero-percent financing.

"As we are seeing higher interest rates, it's more beneficial for consumers to go with the zero percent than the cash rebate," says Jesse Toprak, a senior analyst at Edmunds.com.

Used vehicles are also being affected by high gasoline prices. Resale values for the popular Toyota Prius hybrid and Honda Civic hybrid have been appreciating in recent months, according to Kelley Blue Book, but there hasn't been a steep decline in resale values for SUVs.

A 2004 Prius had a value of \$20,100 in August 2005, but in April, it jumped to \$20,600. A 2005 Prius was estimated to be worth \$21,900 in December, but had a value of \$22,300 in April. For the Civic hybrid, a 2004 model had a value of \$15,150 in August but jumped to \$16,950 in April.

But concerns over gas prices have yet to affect consumer tastes overall when it comes to engine size. According to Power Information Network, a division of J.D. Power & Associates that provides auto-industry analysis, nearly 25% of vehicles sold in the first quarter of 2006 were equipped with eight-cylinder engines, which was roughly the same for July, August and September of last year.

Still, some models have seen consumer tastes shift from six-cylinder to four-cylinder engines, which have better fuel economy. About 95% of consumers who bought a Ford Fusion in October 2005 chose a six-cylinder over a four-cylinder vehicle, but by March, that was down to 51%.