ISSUES RELATING TO THE DOMESTIC AUTO INDUSTRY III

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE
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ISSUES RELATING TO THE DOMESTIC AUTO INDUSTRY—III

TUESDAY, DECEMBER 1, 1981

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON INTERNATIONAL TRADE,
Washington, D.C.

The committee met, pursuant to notice, at 9:30 a.m., the Honorable John C. Danforth (chairman of the subcommittee) presiding.

Present: Senators Danforth (presiding), Dole (chairman of the full committee), Roth, Chafee, Grassley, Bentsen, Baucus, and Bradley.

[The committee press release and Senator Danforth's opening statement follows:]

[Press Release No. 81-180, Nov. 16, 1981]

FINANCE SUBCOMMITTEE ON INTERNATIONAL TRADE SETS HEARING ON AUTOMOBILE INDUSTRY

The Honorable John C. Danforth (R., Mo.), Chairman of the Subcommittee on International Trade of the Committee on Finance announced today that on December 1, 1981, the Subcommittee will hold a hearing to review developments in the U.S. automobile industry and the U.S. market for automobiles since April 1981.

Chairman Danforth stated that the Subcommittee on Trade will also review (1) projections for the U.S market for automobiles and (2) foreign automakers' purchases of U.S.-made parts including results of the Japanese Automobile Parts Purchasing Mission of September 1980.

The hearing will begin at 9:30 a.m. in Room 2221 of the Dirksen Senate Office Building.

Chairman Danforth stated that administration witnesses are expected to testify. Public witnesses are also invited to request to testify.

OPENING STATEMENT OF SENATOR JOHN C. DANFORTH

Today we take another look at the American auto industry "Another look," because this is the third hearing we have held in this Committee since the beginning of the year focusing on the automobile situation. And each look seems more gruesome than the last.

Today, once again, we on the committee are faced with two conflicting objectives as regards the automobile import situation: On the other hand, many of us consider ourselves strong advocates of an international trading system based on a free and fair exchange of goods and services. On the other hand, we cannot allow ourselves to sit idly by and watch the American automobile industry—so vital to our basic industrial structure—whither away into oblivion. Our hearing today will cover both of these objectives.

When we look at America's balance of trade with the rest of the world, the outlook is gloomy at best: In 1971 the U.S. trade balance went into deficit for the first time in more than three quarters of a century. Last year that deficit reached $36 billion on a c.i.f. basis. Today, it appears that the U.S. trade deficit may top over $40 billion in 1981.

But even this dismal trend looks rosy when compared to the statistics characterizing the United States/Japan trade picture: In one year, the U.S. trade deficit with Japan is likely to jump an incredible 50 percent. From an appalling $10 billion bilateral deficit in 1980, we are now facing a deficit upwards of $15 billion in 1981. Moreover, if the trend in our trade relationship since 1970 continues, the Commerce Department has projected a bilateral trade deficit with Japan of $25 billion in 1985—moving as high as $50 billion in 1990.

The remarkable nature of Japan's post-war economic growth cannot be disputed. But this "economic miracle" has, in large measure, come about through the generosity of open American markets and, to a significant degree, at the expense of American products that were at one time more competitive.

The Japanese approach to trade policy combines a successful "infant industry" import strategy, with an export program that has concentrated on targeting and protecting high-growth and high-value added industries. The trade pattern that has resulted from this combination of strategies is most troubling: According to Commerce Department estimates, 95 percent of Japan's exports are manufactured products, while 80 percent of its imports are agricultural commodities and raw materials.

Protection of the Japanese market is maintained in increasingly sophisticated ways, characterized by a complex distribution system, interminable delays and red tape, government procurement policies and discriminatory taxes and regulations. TV's, autos and steel got this treatment in the last two decades; high technology products such as computers and telecommunications have it now.

If American businessmen were the only ones unable to sell their products successfully in Japan, I suppose I could accept the argument that we are not trying hard enough. But this is not the case: Japan's trade surplus with the world reached $25 billion in 1978 and businessmen throughout the world—be they German, Australian or Korean, all complain about the problems they face selling in Japan.

For me, as an elected official and as an American, the prospect of a bilateral deficit with Japan of $15 billion is clearly, clearly unacceptable. Moreover, it is inconceivable that the Government of Japan would tolerate a bilateral trade deficit of $15 billion if the situation were reversed.

I know this problem cannot be corrected overnight. But I also know that unless there are fundamental changes in Japan's approach to trade policy, the situtaion we face today will further deteriorate and the current crisis will be repeated again and again.

Stop-gap actions by Japan may help to alleviate the imbalance in the short term. But ultimately, Japan is going to have to take the painful steps necessary to have a truly open market.

That is the "big picture." Today we are focusing on a significant part of that picture—the automobile situation.

When I held hearings in this Subcommittee in January and again in March, the state of the industry we observed could only be labeled "dismal":

In 1980, the U.S. automakers lost over $4 billion;

Unemployment in the industry reached 250,000, with many more laid off in related industries;

And imports took a record 26.7 percent share of the market.

Then later in the spring, we had occasion for some cautions optimism:

By one projection, the market for automobiles was to rise from a 19 year low of 8.9 million units in 1980 to 9.7 million units in 1981;

American automakers were committed to spending $70–80 billion over a five year period to retool;

And in May, Japan agreed to limit—albeit slightly—its auto exports to this country for two-to-three years. At the same time, the Japanese Ministry of International Trade and Industry (MITI), reiterated its support for the "auto package" negotiated in May of 1980, including Japanese duty restrictions on auto parts, promotion of U.S. parts purchases, and promotion of Japanese automaker investment in the United States.

That was precisely seven months ago. And while it will be some time before the American auto industry regains its competitiveness, it is not too early to take an assessment and ponder the future.

In this regard, I suppose the first thing we must do is admit that our "pondering" in the spring was shaky at best;

Instead of 9.7 million units, auto sales for 1981 will probably drop another 3 percent from 1980 levels to only 8.7 million.

The American automakers entered the fourth quarter over $1 billion in the red and may well finish off the year with losses totalling $1.4 billion. Moreover, there have been some disturbing reports of delays or cancellations of retooling programs worth $1.3 billion.

And unemployment in the auto industry, having dropped to 179,000 in mid-November, is likely to reach 193,000 again early this month.

Finally on the trade side:

Import penetration remains fairly steady at 26.5 percent for the year, due in part to Japan's export restraint and in part to the weakness of the American market.

In the first six months of the Japanese export restraint, shipments of Japanese vehicles represented slightly over half of the 1.68 million units for the first restraint year.

But in the parts purchasing and investment areas, progress has been negligible:

Not only will Japan fall far short of its commitment of September 1980 to promote purchases of $300 million worth of American-made parts,

But with the exception of Honda, none of the major Japanese automakers had moved to invest in the production of passenger cars in the United States—a market worth over $10 billion to them on an annual basis.

Once again let me stress, as I have so many times since the beginning of the year, that import limitations, in and of themselves, will not cure the American auto industry's ills. The other components of the solution, in the form of an improved economic climate, lower interest rates, retooling and better management decisions by American automakers, and reasonable wage settlements on the part of labor, are all necessary ingredients for a revitalized auto industry.

With these thoughts in mind * * *.

Senator DANFORTH. Today's hearing is the third in a series of hearings on the U.S. auto industry. The first one was last January, which was general in nature. Then in March we had a second set of hearings. Today's hearing is more in the nature of a review of where we stand.

I do want to make some initial comments, first about the overall U.S. situation. When we consider that in 1971 the U.S. trade balance went into deficit for the first time in this century, it is remarkable to note that this year, 1981, we may top the $40 billion mark for a trade deficit.

In 1 year our bilateral deficit with Japan alone is likely to jump about 50 percent, from around $10 billion in 1980 to about $15 billion in 1981. Considering the fact that we are in a recession, this marked increase in our trade deficit with Japan is particularly notable.

If the present trend in our trade relationship with Japan continues, the Commerce Department has projected a trade deficit with Japan of $25 billion in 1985, and moving to perhaps $50 billion in 1990. It seems unimaginable, but the trend is unmistakable.

The Japanese have done very well. Their approach to trade policy combines a successful infant industry import strategy with an export program that is concentrated on targeting and protecting growth in high value-added industries.

The trade pattern that has resulted from this combination of strategies is most troubling. According to the Commerce Department's estimates, 95 percent of Japan's exports are manufactured products while 80 percent of its imports are agricultural commodities and raw materials.

Protection of the Japanese market is maintained in increasingly sophisticated ways, characterized by a complex distribution system, interminable delays and redtape, government procurement policies, and discriminatory taxes and regulations. TV's, autos, and steel got this treatment in the last two decades. High technology products, such as computers and telecommunications, have it now.

The prospect of a bilateral deficit with Japan of over $15 billion is clearly unacceptable. Moreover, it is inconceivable that if the shoe were on the other foot the government of Japan would tolerate a trade deficit with the United States of $15 billion—particularly in the face of a recession.

With respect to the auto industry itself, back in January and March when this subcommittee held hearings on the same subject, the outlook for the U.S. auto industry was dismal. In 1980 U.S. automakers lost over $4 billion; unemployment in the industry had reached a quarter of a million, with many more laid off in related industries; imports were taking 26.7 percent of the American market.

Later in the spring things were looking a little bit brighter. By one projection, the market for automobiles was going to be on the rise from 8.9 million in 1980 to 9.7 million in 1981. American automakers were committed to spending $70 to $80 billion for retooling. And then in May, Japan agreed to limit, albeit it slightly, its auto exports to this country for a 2 to 3-year period. At the same time, the Japanese Ministry of International Trade and Industry reiterated its support for the so-called auto package negotiated in May 1980, including Japanese duty reductions on auto parts, promotion of U.S. parts purchases, and promotion of Japanese automaker investment in the United States.

Well, in fact, things have not turned out as well as we had hoped last spring. Instead of increasing to 9.7 million units in 1981, sales will probably decrease about 3 percent from 1980 sales levels to less than 8.7 million cars. American automakers entered the fourth quarter over $1 billion in the red and may well finish the year with losses totaling about $1.4 billion. Unemployment in the auto industry, having dropped in mid-November, is now likely to go back up to about 193,000 early this month.

On the trade side, import penetration remains about the same as it was, thanks to the arrangement that the Japanese entered into last spring. However, in the areas of parts purchasing and investment, progress has been negligible. Not only will Japan fall far short of its commitment in September 1980 to promote purchases of some $300 million worth of American-made parts, but, with the exception of Honda, none of the major Japanese automakers has moved to invest in the production of passenger cars in the United States—a market which is worth over $10 billion to the Japanese on an annual basis.

Senator Dole?

Chairman DOLE. Well, very briefly, first I would commend you, Senator Danforth, for your continued interest in the auto industry, and particularly as it relates to imports.

As you have indicated, this is the third in a series of hearings. There will be others. In my view, this committee has a rather grave responsibility in this entire area, certainly the subcommittee has, and I would say that the full committee will continue to work with the subcommittee because our responsibility cannot be set aside. I would hope that these hearings will indicate that some progress is being made.

It has been 6 months since Japan imposed voluntary restraints. It is difficult to say what the impact has been because of the depressed state of the automotive market in this country as well as the expected lag in actual cutbacks of deliveries to this market. So hopefully the hearing today will give us some indication of what we may expect over the next 12 to 18 months.

These months will be critical to the survival of the industry, and I believe that it will be during this period that the impact of Japanese restraints will be most felt. The next few months will also be critical ones in United States-Japan relations—especially in the trade field—because, as Senator Danforth has pointed out, our trade deficit is probably going to be $15 billion or more in 1982, and we will suffer a total deficit of about $40 billion this year and perhaps more next year.

So it is obvious to me that we have some responsibility in this committee because we cannot go on accepting deficits of this magnitude either across the board or with individual countries.

The automotive problem is an important aspect, but only one aspect, of the larger problem we have with Japan. There is a perception—and I say a perception—which prevails both in the Congress and the country as a whole that artificial barriers prevent U.S. producers from selling in Japan. In the automobile sector, for example, it is alleged that unreasonable technical standards prevent U.S. producers from ever selling replacement parts for Japanese cars in this country.

I might add that we also have the same complaints when you get into the agricultural sector, and we are in the midst of trying to resolve some of the problems with that area at this very time.

In any event, the issues need to be fully aired. If, in fact, such unreasonable restraints exist, they must be brought to the Government's attention, and then it is incumbent upon the Government to see that they are eliminated.

Equally important is the necessity of insuring that our Japanese friends understand that the barriers and even perceptions of barriers to entry into their home market are eroding support for the international trading system. In the long run, such barriers and perceptions generate counterproductive actions not only in this country but around the world.

So I am very pleased to participate in the hearings this morning. I know that these issues have been raised before, but it will take continued efforts such as these and other efforts by those who have a responsibility in this administration to get results. It will also take cooperation, and I am not criticizing the Japanese. I read briefly the comments made by Ambassador Brock in this morning's paper where he indicated to both sides that there was room for improvement.

So we are very pleased to be here. And again, I thank the chairman for his efforts.

[The prepared statement of Senator Dole follows:]

STATEMENT OF SENATOR BOB DOLE

Thank you Mr. Chairman, it has been six months since Japan imposed voluntary restraints on automobile exports to the United States. At this point it is difficult to say what impact these restraints have had because of the depressed state of the automotive market in this country as well as the expected lag in actual cutbacks of deliveries to this market. I am hopeful that today's hearing will provide us with a clearer picture of the current market as well as reasoned estimates of conditions over the next 12 to 18 months.

These months will be critical to the survival of the industry and I believe that it will be during this period that the impact of the Japanese restraints will be most felt. They will also be critical months in United States-Japan relations, especially in the trade field. Our trade deficit with Japan is likely to be over $15 billion this year and present forecasts suggest that it could well be higher in 1982. We will suffer a $40 billion total deficit this year and perhaps more next year. It is obvious to me that we cannot go on accepting deficits of this magnitude, either across the board or with individual countries.

The automotive problem is an important aspect, but only one aspect of a larger problem which we have with Japan. There is a perception which prevails both in the Congress and the country as a whole that artificial barriers prevent U.S. producers from selling in Japan. In the automobile sector it is alleged that unreasonable technical standards prevent U.S. producers from ever selling replacement parts for Japanese cars in this country.

These issues need to be fully aired. If such unreasonable restraints exist they must be brought to the Government's attention and then it is incumbent upon the Government to see that they are eliminated. As important, it is necessary to make certain that our Japanese friends understand that the barriers and even perceptions of barriers to entry into their home market are eroding support for the international trading system. In the long run they generate counterproductive actions not only on this country but around the world.

Mr. Chairman, I know that these issues have been raised before but it appears that it will take continued efforts like that which you are undertaking today to get results.

Senator DANFORTH. Thank you, Senator Dole.

The first witnesses are the Government witnesses, a panel of four, David Macdonald, Deputy U.S. Trade Representative; Lionel Olmer, Under Secretary of Commerce; Robert Dederick, Assistant Secretary of Commerce; and Robert Hormats, Assistant Secretary of State.

Ambassador MACDONALD. Mr. Chairman?

Senator DANFORTH. Ambassador Macdonald.

Ambassador MACDONALD. I have an eight-page prepared statement that I would like to submit for the record.

May I summarize from it?

Senator DANFORTH. That is fine. All written statements will be included in the record in full, so if you could summarize, we would appreciate it.

STATEMENT OF HON. DAVID MACDONALD, DEPUTY U.S. TRADE REPRESENTATIVE

Ambassador MACDONALD. Allow me to begin by reviewing the deteriorating conditions of the auto industry while expressing the President's confidence that the economic program will provide the impetus for capital investment which is necessary to the solid improvement of the industry and to the maintenance and recapture by the industry of the leading edge of technological improvements that is necessary to compete today in a world market.

The statement then goes on to describe the restraint terms that the Japanese have promulgated. It might be helpful to read that part.

The Japanese have voluntarily restrained their exports of autos for a 3-year period. The extent of the restraint for the first year, from April 1, 1981, to March 30, 1982, was 1,680,000 units. The second and third years are more indefinite. In the second year, 16.5 percent of any increase or decrease in projected sales over the first, year's projections will be added or deducted. The third year is open to further consultations.

The U.S. Trade Representative's office looks at the Japanese auto restraint in the context of our overall trade policy as an aberration, voluntarily entered into by the Japanese and gratefully accepted as an interim measure to assist our auto industry through a difficult period of adjustment through capital infusion.

The statement then goes on to review the present status of Japanese performance under the restraint agreement, noting that during the April-August period and actually April-September period—we have supplemental figures for September—these Japanese exports of passenger cars appear slightly to exceed the level of restraint that might be anticipated if the restraint were prorated on a monthly basis across the year however, but we agree that the Japanese wish to be reviewed on an annual basis, and we are confident thay by the time the year ends they will be under or at the figure that they indicated would be their restraint level.

We are, however, monitoring their performance on a monthly basis and keeping a close eye on the first restraint year.

The statement then goes on to point out that the restraint for the first year was based upon a 10 million auto sales forecast for the year in question, which was the best forecast that everyone seemed to agree upon in this country. But, the results have been much worse. It now appears that there will be perhaps 8.5 million cars sold in this country, and as a result, the Japanese market penetration will be up from its anticipated percentage of 16.8 percent to 19.3 percent in Japanese fiscal year 1981, the first year of the restraint.

There have not been discussions with respect to the second year of the restraint as of yet.

The statement then discusses technical problems that the USTR is working on with respect to the export of autos and parts to Japan and notes that although progress has been slow, some progress has been made. In particular, the Ministry of International Trade and Industry has issued a statement specifying how they would liberalize the procedures U.S. manufacturers must follow in having automobiles approved. We have yet to see real concrete benefits from that.

The statement then reviews quickly the auto parts commitment by the Japanese Government,—a topic I believe Under Secretary Olmer will cover in more detail.

It also notes that there are two proposals before Congress, the Fithian resolution and the Ottinger bill, and on page 5 we reiterate our sympathy toward but opposition to those bills as resulting in performance requirements which are the same sort of thing that we as a government are trying to dismantle in other countries.

In conclusion, I would like to say that we should access the Japanese voluntary restraint on exports of its autos both in the context of our overall trade relationship with Japan and in the context of our overall trade policy toward our own auto industry.

With respect to our trade relationship with Japan, the Japanese auto export restraints should not be allowed to become a precedent for our trade relationship with that country. The restraint was a modest, medium-term device designed to assist the auto industry in accumulating capital necessary for a major retooling to meet the markets of the 1980's. We are appreciative of the Japanese Government's willingness to assist the industry in that respect.

But sectoral problems like this cannot blind us from focusing on our overall trade relationship with Japan. When this relationship is examined, it becomes apparent, as you have just said, Mr. Chairman, that we must concentrate on those measures that increase our exports, not those that decrease Japanese imports. One aspect of this objective is the examination of alleged Japanese nontariff barriers and the removal of those barriers where they are found.

Some people would say that there are 115 Japanese nontariff barriers, one for each citizen of Japan. The reason for that is because there is an attitudinal problem of opposition which I can only describe as anti-import, and we have to address this in the most frank and blunt manner and see what we can do to overcome it. If we do not, it is our feeling that the trading system as we know it today will undergo substantial modification.

In response, I am leading an interagency task force going to Japan next week for the purpose of taking up this matter with the Japanese and hopefully reversing a trend that has grown up over the last 5 or 6 years with the bilateral trade deficits in this country.

That really is the substance of the statement, Mr. Chairman.

Thank you.

[The prepared statement of Ambassador Macdonald follows:]

Statement of Ambassador David Macdonald
Deputy U.S. Trade Representative
before the
Senate Finance Committee
Subcommittee on International Trade
Hearings on the Automobile Industry

December 1, 1981

Mr. Chairman, I am pleased to appear before the Subcommittee this morning to discuss the situation of the U.S. auto industry and its international ramifications.

The financial situation within the domestic auto industry is getting progressively worse. Fourth-quarter output is being trimmed by a further 7 percent from what had been anticipated, in response to the worst October sales period in years. In the first 20 days of October, U.S. car sales fell 31 percent from a year earlier; continuing high interest rates and consumer uncertainty contributed to the collapse. We believe, however, that the President's economic program, combined with a downturn in interest rates and a general economic recovery, will in the long run help the auto industry get back on its feet.

In the meantime, the Japanese have voluntarily restrained their exports of autos for a three-year period. The extent of the restraint for the first year (April, 1 1981 to March 30, 1982) was 1,680,000 units. The second and third years are much more indefinite. In the second year, 16.5% of any increase or decrease in projected sales over the first year's projections will be added or deducted. The third year is open to further consultations.

We look at the Japanese auto restraint program as an aberration, voluntarily entered into and gratefully accepted as an interim measure to assist our auto industry through a difficult period of adjustment, through capital infusion.
To date, the imports of Japanese automobiles appear to reflect the levels of restraint adopted by the Japanese Government earlier this year.

Recently released figures from the Department of Commerce show that during the period of April-August 1981, 655,096 passenger cars exported from Japan arrived in the United States. While this exceeds slightly the level of restraint that would be anticipated if the annual restraint level was proportionately divided over the five-month period, the United States is evaluating the restraint only on an annual basis. Recently received figures indicate that September was the fourth straight month that Japanese car exports to the United States have declined.

We are monitoring the performance of the restraint program on a monthly basis, and are keeping a close eye on how the first restraint year progresses. The 10 million forecast of U.S. car demand, in connection with the first year of Japanese export restraints, now seems to have been overly optimistic. The first-year domestic demand now looks like only 8.5 million. As a result, Japanese market penetration will be up to an estimated 19.3 percent in Japanese FY 1981 as opposed to the 16.8 percent expected last spring. Thus, while the export restraint is working as expected, the effect is not as positive as had been anticipated, since the U.S. auto market is doing considerably worse than predicted.

The Japanese have not yet started deliberations on their export restraints for the second year, which starts in April 1982. At the time that the Japanese begin their deliberations, we will share with them our views on the U.S. market and industry situation.

Japanese Market for U.S. Car Exports

Our automotive manufacturers have traditionally had very limited access to the Japanese market, the cause of which is a matter of some disagreement. The U.S. industry feels that exports would increase with a liberalization of the stringent Japanese standards requirements. As a result, bilateral discussions on automobile standards-related issues have been ongoing with the Japanese for some time. Progress has been made in some areas. For example, the Japanese now send inspectors to the United States, and in May 1980, the Japanese Ministry of International Trade and Industry (MITI) issued a statement specifying how they would liberalize the procedures U.S. manufacturers must follow in having automobiles approved. Significant concrete results, however, have not yet been achieved.

We ~~intend~~ to keep working with Japan to make its market more open to U.S. exports, particularly in areas where the United States has a comparative advantage.

The Carter Administration sought a significant increase in U.S. exports of auto parts to Japan. In February 1981, the Trade Facilitation Committee (TFC) obtained from MITI a planned target of $300 million worth of auto parts to be purchased from the United States in 1981. To date, however, U.S. sales of auto parts have fallen far short of this estimate. There is a growing overall U.S. deficit with Japan in auto parts, especially in those products we are competitive in, which raises serious doubts as to the openness of the Japanese market.

Proposed U.S. Legislative Responses to the Japanese Car Import Problem

There are now two Congressional proposals that address the issue of local content for the American auto industry. The Fithian resolution was introduced on September 10 and was referred to the House Ways and Means Committee. The Ottinger bill has not yet been introduced. Both would require Japanese auto manufacturers to use a certain percentage of U.S. parts and components in their cars for sale in the United States.

These are not the same as local content requirements, which many LDCs impose on foreign companies that locate assembly plants there and export the finished product. Instead, these are requirements on imports into the United States. As such, they could be alleged to amount to a quantitative restriction on Japanese automobile exports, which would effectively limit the importation value of Japanese cars and automotive equipment. Action imposing such restrictions vis a vis Japan alone raises serious questions whether the United States would be in violation of Article I of the GATT, mandating MFN application of any trade restrictions. On the other hand, applying such local content requirements globally may result in the nullification and impairment of GATT tariff concessions the United States has made over the years in multilateral tariff negotiations.

The Administration has taken a strong position in trying to liberalize the performance requirements many American multinationals face in investing abroad. Imposing them domestically would deal a severe blow to these efforts.

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Conclusion

The Japanese voluntary restraint on exports of its autos should be assessed both in the context of our overall trade relationship with Japan and in the context of our overall policy toward our own auto industry.

(1) With respect to our trade relationship with Japan, the Japanese auto export restraint should not be allowed to become a precedent for our trade relationship with that country. This restraint was a modest, medium-term device designed to assist the auto industry in accumulating capital necessary for a major retooling to meet the markets of the 1980s. We are appreciative of the Japanese Government's willingness to assist the industry in this respect.

Sectoral or industry problems, however, cannot blind us from focusing on our overall trade relationship with Japan. When this relationship is examined, it becomes apparent that we must concentrate on those measures that increase our exports, not those that decrease Japanese imports. One aspect of this objective is the examintion of alleged Japanese nontariff barriers and the removal of those barriers where they are found. In a broader sense, however, the real problem, in our view, is an attitude prevalent in Japan which can only be characterized as anti-imports. For the purpose of addressing these problems, I am leading an interagency delegation to Tokyo on December 9-10 in order to consult on this problem with our Japanese counterparts. We intend to convey the seriousness of Congress' concern over the perceived lack of access to the Japanese market.

(2) With respect to our own auto industry, the restraint imposed by MITI on Japanese exports to the United States should not be conceived as <u>the</u> solution to the industry's problem. The survival of the American auto industry over the long term will not depend on quantitative restraints on Japanese imports, but rather on government and business policies that increase the productivity of the American autoworker. The past failure of our industry to keep pace with Japan and other auto manufacturers has many causes. In the past, capital expenditures by the U.S. auto manufacturers have been diverted into areas (such as questionable "safety" requirements) that siphoned off badly-needed capital that could have improved productivity. In addition, the past gasoline allocation and price control programs of this government have created artificial gasoline scarcity and lines at the gas pump, which caused many buyers to panic and immediately demand fuel the efficient cars that the Japanese were able to supply. Other government regulations have also placed the U.S. industry at a disadvantage with its foreign competitors. Finally, the industry itself has allowed its own labor costs to rise above those that would allow it to retain its domestic market shares. Nevertheless, both the industry and its workers now appear committed to deal expeditiously and progmmatically with the overriding need to restore competitiveness in this central sector. The U.S. Government shares that commitment and hopes that Japan recognizes both the seriousness of the problem and our efforts to solve it.

Senator DANFORTH. Thank you, Ambassador.

Mr. Olmer?

Mr. OLMER Thank you, Mr. Chairman.

Mr. Dederick and I appreciate the opportunity to come before your committee and present to it the views of the Commerce Department on recent developments in the automobile industry.

Senator DANFORTH. Would you speak a little more closely into the microphone, please?

Mr. OLMER. Yes, sir. To present our views in the Commerce Department on recent developments in the automobile industry, and with respect to the automobile industry and our trade problems with Japan.

Mr. Dederick will review the current state of implementation of the President's auto program which was announced last April. Following his remarks, I would like to comment briefly, if I may, on the relevance of the industry's problems in the context of overall United States-Japan trade.

With your permission, Mr. Dederick will start.

STATEMENT OF HON. ROBERT G. DEDERICK, ASSISTANT SECRETARY FOR ECONOMIC AFFAIRS, DEPARTMENT OF COMMERCE

Mr. DEDERICK. Mr. Chairman, I am pleased to appear before you today.

Before going into specifics, let me make one general point. While the months immediately ahead will continue to be difficult for the U.S. auto industry, longer term prospects are more favorable, and I see no reason not to anticipate a viable American automotive industry in coming years.

Now, as you are aware, the U.S. automobile market has been in a severe slump since the spring of 1979. We anticipate that total new car sales for 1981 will fall to 8.7 million units, down 22 percent from 1978, the industry's last peak year. Sales during 1981 of domestic-made new cars will fall to about 6.4 million units, off 30 percent from 1978. With sales of imports at 2.3 million units, the import penetration ratio for the entire year should average out at 26.5 percent.

The light truck market is even less encouraging. Total light truck sales will end 1981 at an estimate 2 million to 2.1 million units, 45 percent under the 1978 peak. Sales of domestic-made light trucks for the year will be an estimate 1.6 million units, 53 percent below the 1978 peak.

Now, obviously the industry's sales outlook for 1982 will be dominated by the timing and vigor of the recovery from the recession. Many forecasts, including our own, point to passenger car sales in the range of 9 million to 9.5 million units, of which 2.3 million to 2.4 million will be imports. We expect that total light truck sales for the year will be 2.3 million units. These estimates mean for the industry as a whole a better year than 1981, probably better than 1980, but still one considerably poorer than 1979 and 1978.

Unlike the previous automotive recessions, the present one is not entirely cyclical in nature. In addition to cyclical influences, the downturn in domestic-made sales reflects an apparent slowdown in the long term growth rate of demand for automobiles together with the impact of sharply intensified international competition for the U.S. market.

The slower growth rate results from demographic factors, erosion of consumers' discretionary purchasing power by inflation, and sizeable increases in the relative price of owning and operating a car.

To these factors must be added the widespread perception among consumers that the quality of foreign imports exceeds that of domestic-made cars, a consumer attitude that we cannot expect to see reversed overnight.

And finally, there is the factor of the relative cost advantage of Japanese auto manufacturers, which most recent studies put at between $1,000 and $1,500 per unit.

On this last point, U.S. producers' enormous investment outlays over the last several years have been directed in part at narrowing the cost gap, but severe cash flow pressures now appear to be causing investment stretchouts and postponements, to the detriment of longer term competitive prospects. Moreover, I see no reason to believe that the Japanese are going to stand still, which implies a longstanding cost challenge for our companies.

I want to turn now to the President's program for the domestic auto industry. Before summarizing its accomplishments, I would like to remind the committee of two themes the President emphasized when he introduced the program. The first was that revitalization of the auto industry depends upon revitalization of the entire American economy. The second was that central responsibility for industry recovery lies with management and labor, not with Government.

The first step in the President's program called for the enactment of his economic recovery program, and the main elements have now been put in place.

Temporarily we are going through the inevitable pain of wringing inflation out of the economy, but the groundwork is being laid for a strong pickup in economic activity in the second half of 1982. As the recovery develops, there is no question that the business tax provisions in the program will help give the auto companies a much-needed injection of higher cash flows. The leasing provisions in the new tax law will also help with additional means of improving cash flow.

Next, the President's program called for review, rescission or reproposal of 34 auto-related regulations. To date, eight EPA actions and eight NHTSA actions have been completed. Preliminary data on the potential savings to the industry from these regulatory moves suggest that capital savings of $500 million to $600 million will be achieved. As an aside, the industry would benefit from the adoption of legislation such as that being considered by Congress to relax emission standards.

In the antitrust area, the President's program has also made substantial progress. On June 29, the Department of Justice advised the court that the Government wished to withdraw its motion to extend prohibitions against certain cooperative ventures among auto companies and against joint presentations by auto companies before regulatory agencies. Further, Justice has decided to seek court modification of what is called the smog decree to permit the auto companies to engage in joint research ventures that would otherwise be unlawful under the antitrust laws.

As regards the trade aspects of the auto program, the Department of Commerce has put into operation a system to monitor closely U.S. imports of Japanese-made cars. Beyond that, the Department has pursued an active program related to the auto parts industry.

I will leave the rest of the discussion on trade to Under Secretary Olmer.

In the area of worker assistance, another component of the President's package, amendments to the trade adjustment assistance program should result in more effective use of Government assistance to unemployed autoworkers. The changes reflect the hard realities of an absolutely austere budget, but recognize that retraining, relocation, and placement of displaced workers in secure new jobs should be the true aim of any adjustment assistance program.

Finally, in one specific but minor area, budget considerations clearly took precedence over what had originally been proposed in the President's program; a budget request to Congress of $100 million to accelerate Federal purchases of cars and trucks was denied.

The Department of Commerce has responsibility for monitoring, coordinating, and ramrodding, if need be, the implementation of the President's auto industry program. I am happy to be able to report that the Department has not had to ramrod when it comes to the execution of the program. The progress already made demonstrates that the agencies assigned tasks have pressed forward vigorously. In Commerce we have taken many of the steps required to continue to coordinate Government activities associated with the auto industry. Transfer of responsibilities from the Department of Transportation to Commerce has occurred. Commerce is working now on a regular basis with the Transportation Systems Center in Cambridge. Within Commerce we are expanding our autostaff. We are preparing status reports on industry developments—the committee was given a copy of one—and we intend to make this a regular product.

We have established an interagency network to monitor progess on the President's program. And after a great deal of searching, we have selected an individual to head-up our autocoordination effort. We expect to be able to announce his name very shortly.

I am aware that there are individuals who would like to see the Government doing more, but in response to those urging much deeper Government involvement, I would point out that the record of the past gives little reason to believe that any amount of Government assistance directed at an industry can make that industry truly healthy and competitive again. Our tasks are to restore the aggregate economy to noninflationary vitality and to eliminate unnecessary impediments to industrial performance. We are tackling those tasks. The rest belongs to management and labor within the auto industry itself.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Dederick follows:]

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STATEMENT OF ROBERT G. DEDERICK

ASSISTANT SECRETARY FOR ECONOMIC AFFAIRS

BEFORE THE

SUBCOMMITTEE ON TRADE

OF THE

SENATE FINANCE COMMITTEE

DECEMBER 1, 1981

MR. CHAIRMAN, I AM PLEASED TO APPEAR BEFORE YOU TODAY TO DISCUSS THE STATUS OF THE AMERICAN AUTOMOBILE INDUSTRY AND THE PROGRESS OF THE PRESIDENT'S PROGRAM TO ASSIST THE INDUSTRY.

THE DIFFICULTIES OF THE AUTO INDUSTRY CANNOT BE ATTRIBUTED TO ANY ONE CAUSE. IN PART THE PROBLEMS REFLECT THE VERY BASIC CHANGES OCCURRING IN THE DEMAND FOR PASSENGER CARS AND LIGHT TRUCKS. IN PART THEY REFLECT THE UNSETTLED ECONOMIC CONDITIONS INHERITED FROM THE PAST. IN PART THEY REFLECT DECISIONS MADE BY THE INDUSTRY ITSELF, DECISIONS WHICH--ALONG WITH DEVELOPMENTS ABROAD--HAVE ERODED THE INDUSTRY'S INTERNATIONAL COMPETITIVENESS. AND IN PART THEY REFLECT IMPEDIMENTS THAT GOVERNMENT HAS IMPOSED ON THE INDUSTRY.

THE MONTHS IMMEDIATELY AHEAD WILL CONTINUE TO BE DIFFICULT FOR THE INDUSTRY. BUT LOOKING BEYOND, I SEE REASONS FOR OPTIMISM. THE ADMINISTRATION IS ATTACKING THE UNSETTLED ECONOMIC CONDITIONS AND THE NEEDLESS IMPEDIMENTS. THE INDUSTRY IS MAKING, BY ANYBODY'S STANDARDS, AN EXTRAORDINARY EFFORT TO RESPOND TO THE CHANGES IN MARKET DEMAND. MANAGEMENT AND LABOR APPEAR TO BE INCREASINGLY COMMITTED TO THE STEPS REQUIRED TO RESTORE THE INDUSTRY'S INTERNATIONAL COMPETITIVENESS.

NEVERTHELESS, THERE IS DEBATE ABOUT WHETHER THE INDUSTRY WILL EVER RETURN TO ITS BEST PERFORMANCE LEVELS OF THE PAST. TIME WILL SETTLE THAT ARGUMENT. BUT, REGARDLESS OF THE OUTCOME, I SEE NO REASON NOT TO ANTICIPATE A VIABLE, ALBEIT CHANGED, AMERICAN AUTOMOTIVE INDUSTRY IN THE YEARS AHEAD.

BECAUSE SALES DICTATE EVERYTHING ELSE THAT HAPPENS WITHIN THE INDUSTRY, I WOULD LIKE TO SUMMARIZE OUR VIEWS ON SALES PROSPECTS FOR 1981 AND 1982.

INDUSTRY SALES FOR 1981

THE U.S. AUTOMOBILE MARKET HAS BEEN IN A SEVERE SLUMP SINCE THE SPRING OF 1979. WE ANTICIPATE THAT TOTAL NEW CAR SALES FOR

1981 WILL FALL TO 8.7 MILLION UNITS, DOWN ONLY 3 PERCENT FROM 1980 (ANOTHER DISMAL YEAR) BUT DOWN 22 PERCENT FROM 1978, THE INDUSTRY'S LAST PEAK YEAR. SALES DURING 1981 OF DOMESTIC-MADE NEW CARS WILL FALL TO ABOUT 6.4 MILLION UNITS, OFF 3 PERCENT FROM 1980 AND 30 PERCENT FROM 1978. WITH SALES OF IMPORTS AT 2.3 MILLION UNITS, THE IMPORT PENETRATION RATIO FOR THE ENTIRE YEAR SHOULD AVERAGE OUT AT 26.5 PERCENT, A HAIR BELOW LAST YEAR'S FIGURE OF 26.7 PERCENT.

THE LIGHT TRUCK PICTURE IS EVEN LESS ENCOURAGING. TOTAL LIGHT TRUCK SALES WILL END 1981 AT AN ESTIMATED 2.0 to 2.1 MILLION UNITS, ABOUT 7 PERCENT LESS THAN LAST YEAR AND 45 PERCENT UNDER THE 1978 PEAK. SALES OF DOMESTIC-MADE LIGHT TRUCKS FOR THE YEAR WILL BE AN ESTIMATED 1.6 MILLION UNITS, DOWN 8 PERCENT FROM 1980 AND 53 PERCENT FROM THE 1978 PEAK.

SALES OUTLOOK FOR 1982

OBVIOUSLY THE INDUSTRY'S SALES OUTLOOK FOR 1982 WILL BE DOMINATED BY THE TIMING AND VIGOR OF THE RECOVERY FROM THE RECESSION. MANY FORECASTS, INCLUDING OUR OWN, POINT TO PASSENGER CAR SALES IN THE RANGE OF 9.0 to 9.5 MILLION UNITS, OF WHICH 2.3 to 2.4 MILLION UNITS

WILL BE IMPORTS. PARTLY REFLECTING THE ANTICIPATED INTRODUCTION IN 1982 OF NEW LINES OF MINI PICKUP TRUCKS BY THE DOMESTIC MANUFACTURERS, WE EXPECT THAT TOTAL LIGHT TRUCK SALES FOR THE YEAR WILL BE 2.3 MILLION UNITS. THESE ESTIMATES MEAN A YEAR BETTER THAN 1981, AND PROBABLY 1980, BUT STILL ONE CONSIDERABLY POORER THAN 1979 AND 1978.

BASIC CAUSES OF THE INDUSTRY'S PROBLEMS

UNLIKE THE PREVIOUS AUTOMOTIVE RECESSIONS, THE PRESENT ONE IS NOT ENTIRELY CYCLICAL IN NATURE. IN ADDITION TO CYCLICAL INFLUENCES THE DOWNTURN IN DOMESTIC-MAKE SALES REFLECTS AN APPARENT SLOWDOWN IN THE LONG-TERM GROWTH RATE OF DEMAND FOR AUTOMOBILES, TOGETHER WITH THE IMPACT OF SHARPLY INTENSIFIED INTERNATIONAL COMPETITION FOR THE U.S. MARKET.

THE SLOWER GROWTH RATE FOR AUTOMOTIVE DEMAND RESULTS FROM (1) DEMOGRAPHIC FACTORS (A DECLINE IN THE GROWTH RATE OF THE DRIVING AGE POPULATION), (2) EROSION OF CONSUMERS' DISCRETIONARY PURCHASING POWER BY INFLATION (WHILE WE INTEND TO REVERSE THIS TREND, FULL

RECOVERY WILL TAKE CONSIDERABLE TIME.) AND (3) SIZABLE INCREASES IN THE RELATIVE PRICE OF OWNING AND OPERATING A CAR. (SINCE THE BEGINNING OF 1978 THE COSTS OF OPERATING A CAR HAVE INCREASED AT TWICE THE RATE OF INCREASE OF NEW CAR PRICES.)

TO THESE FACTORS MUST BE ADDED THE WIDESPREAD PERCEPTION AMONG CONSUMERS--WHETHER RIGHT OR NOT IS ANOTHER ISSUE--THAT THE QUALITY OF FOREIGN IMPORTS EXCEEDS THAT OF DOMESTIC MADE CARS--A CONSUMER ATTITUDE THAT WE CANNOT EXPECT TO SEE REVERSED OVERNIGHT. AND FINALLY, THERE IS THE FACTOR OF THE RELATIVE COST ADVANTAGE OF JAPANESE AUTO MANUFACTURERS, WHICH RECENT STUDIES PUT AT BETWEEN $1,000 and $1,500 PER UNIT--INDEED SOME SUGGEST AN EVEN HIGHER FIGURE. ON THIS LAST POINT, IT IS PERFECTLY CLEAR THAT U.S. PRODUCERS KNOW THE FACTS AND THAT THEIR ENORMOUS INVESTMENT OUTLAYS OVER THE LAST SEVERAL YEARS HAVE BEEN DIRECTED IN PART AT NARROWING THE COST GAP. BUT SEVERE CASH FLOW PRESSURES NOW APPEAR TO BE CAUSING INVESTMENT STRETCHOUTS AND POSTPONEMENTS, TO THE DETRIMENT OF LONGER TERM COMPETITIVE PROSPECTS. MOREOVER, I DO NOT SEE ANY REASON TO BELIEVE

THAT THE JAPANESE WILL STAND STILL, WHICH IMPLIES A LONGSTANDING COST CHALLENGE FOR OUR COMPANIES.

ACCOMPLISHMENTS UNDER THE PRESIDENT'S AUTO INDUSTRY PROGRAM

I WANT TO TURN NOW TO THE PRESIDENT'S PROGRAM FOR THE DOMESTIC AUTO INDUSTRY. BEFORE SUMMARIZING ITS ACCOMPLISHMENTS, I WOULD LIKE TO REMIND THE COMMITTEE OF TWO THEMES THE PRESIDENT EMPHASIZED WHEN HE INTRODUCED THE PROGRAM. THE FIRST WAS THAT REVITALIZATION OF THE AUTO INDUSTRY DEPENDS UPON REVITALIZATION OF THE ENTIRE ECONOMY. THE SECOND WAS THAT CENTRAL RESPONSIBILITY FOR INDUSTRY RECOVERY LIES WITH MANAGEMENT AND LABOR. I CITE THESE POINTS BECAUSE IT IS IMPORTANT TO RECOGNIZE THAT THE PRESIDENT'S PROGRAM NEVER INTENDED THAT GOVERNMENT SHOULD "SOLVE" THE PROBLEMS OF THE AUTO INDUSTRY. WHILE THE ADMINISTRATION IS FIRMLY COMMITTED TO BUILDING A STRONG ECONOMY AND DISMANTLING UNJUSTIFIED INTERFERENCE IN INDUSTRY AFFAIRS, IT IS JUST AS FIRMLY COMMITTED TO INSISTING THAT BUSINESS SHOULD SOLVE THE PROBLEMS OF BUSINESS.

THE FIRST STEP IN THE PRESIDENT'S PROGRAM CALLED FOR THE ENACTMENT OF HIS ECONOMIC RECOVERY PROGRAM. THE MAIN ELEMENTS HAVE, OF COURSE, NOW BEEN PUT IN PLACE. TEMPORARILY, WE ARE GOING THROUGH THE

INEVITABLE PAIN OF WRINGING INFLATION OUT OF THE ECONOMY, BUT THE GROUNDWORK IS BEING LAID FOR A STRONG PICKUP IN ECONOMIC ACTIVITY IN THE SECOND HALF OF 1982. AS THE RECOVERY DEVELOPS, THERE IS NO QUESTION THAT THE NEW BUSINESS TAX PROVISIONS IN THE PROGRAM WILL HELP GIVE THE AUTO COMPANIES A MUCH NEEDED INJECTION OF HIGHER CASH FLOWS. FURTHER, AS THE ARRANGEMENTS RECENTLY ANNOUNCED BY FORD AND CHRYSLER SHOW, THE LEASING PROVISIONS IN THE NEW TAX LAW PROVIDE THE AUTO MANUFACTURERS WITH AN ADDITIONAL MEANS TO IMPROVE THEIR CASH FLOW.

NEXT, THE PRESIDENT'S PROGRAM CALLED FOR THE REVIEW, RESCISSION, OR REPROPOSAL OF 34 AUTO-RELATED REGULATIONS. TO DATE, EIGHT EPA ACTIONS (OUT OF 17) AND EIGHT NHTSA ACTIONS (OUT OF 17) HAVE BEEN COMPLETED. PRELIMINARY DATA ON THE POTENTIAL SAVINGS TO THE INDUSTRY FROM THESE REGULATORY ACTIONS SUGGEST THAT CAPITAL SAVINGS OF $500 TO $600 MILLION WILL BE ACHIEVED.

IN THE ANTITRUST AREA THE PRESIDENT'S PROGRAM HAS ALSO MADE SUBSTANTIAL PROGRESS. ON JUNE 29 THE DEPARTMENT OF JUSTICE ADVISED THE COURT THAT THE GOVERNMENT WISHED TO WITHDRAW ITS MOTION TO EXTEND PROHIBITIONS AGAINST CERTAIN COOPERATIVE VENTURES AMONG AUTO COMPANIES

AND AGAINST JOINT PRESENTATIONS BY AUTO COMPANIES BEFORE REGULATORY AGENCIES. FURTHER, JUSTICE HAS DECIDED TO SEEK COURT MODIFICATION OF WHAT IS CALLED THE SMOG DECREE, TO PERMIT THE AUTO COMPANIES TO ENGAGE IN JOINT RESEARCH VENTURES THAT WOULD OTHERWISE BE LAWFUL UNDER THE ANTITRUST LAWS. AS AN ECONOMIST RATHER THAN A LAWYER, I HAD BEST MOVE ON TO STEP FOUR IN THE PRESIDENT'S PROGRAM, WHERE AGAIN WE HAVE MADE CONSIDERABLE PROGRESS.

THE DEPARTMENT OF COMMERCE HAS PUT INTO OPERATION A SYSTEM TO MONITOR CLOSELY U.S. IMPORTS OF JAPANESE-MADE CARS. BEYOND THAT, THE DEPARTMENT HAS PURSUED AN ACTIVE PROGRAM RELATED TO THE AUTO PARTS INDUSTRY. I'LL LEAVE THE REST OF THE DISCUSSION ON TRADE ASPECTS OF THE AUTO PROGRAM TO UNDER SECRETARY OLMER.

IN THE AREA OF WORKER ASSISTANCE, ANOTHER COMPONENT OF THE PRESIDENT'S PROGRAM, AMENDMENTS TO THE TRADE ADJUSTMENT ASSISTANCE PROGRAM SHOULD RESULT IN MORE EFFECTIVE USE OF GOVERNMENT ASSISTANCE TO UNEMPLOYED AUTO WORKERS. THE CHANGES REFLECT THE HARD REALITIES OF AN AUSTERE BUDGET BUT RECOGNIZE THAT RETRAINING, RELOCATION, AND

PLACEMENT OF DISPLACED WORKERS IN SECURE NEW JOBS SHOULD BE THE TRUE AIM OF ANY ADJUSTMENT ASSISTANCE PROGRM. UNDER THE ADMINISTRATION'S APPROACH, ADJUSTMENT ASSISTANCE FINALLY SHOULD BEGIN TO LIVE UP TO THIS AIM.

FINALLY, IN ONE SPECIFIC BUT MINOR AREA, BUDGET CONSIDERATIONS CLEARLY TOOK PRECEDENCE OVER WHAT HAD ORIGINALLY BEEN PROPOSED IN THE PRESIDENT'S PROGRAM. A BUDGET REQUEST TO CONGRESS OF $100 MILLION TO ACCELERATE FEDERAL PURCHASES OF CARS AND TRUCKS WAS DENIED.

AUTO COORDINATION

THE DEPARTMENT OF COMMERCE HAS THE RESPONSIBILITY FOR MONITORING, COORDINATING, AND RAMRODDING IF NEED BE, THE IMPLEMENTATION OF THE PRESIDENT'S AUTO INDUSTRY PROGRAM. I AM PLEASED TO BE ABLE TO REPORT THAT THE DEPARTMENT HAS NOT HAD TO FUNCTION AS A RAMROD WHEN IT COMES TO THE EXECUTION OF THE PROGRAM. THE PROGRESS ALREADY MADE DEMONSTRATES THAT THE AGENCIES ASSIGNED TASKS UNDER THE PROGRAM HAVE PRESSED FORWARD VIGOROUSLY. IN COMMERCE WE HAVE TAKEN MANY OF THE STEPS REQUIRED TO CONTINUE ~~TO~~ COORDINATE GOVERNMENT ACTIVITIES ASSOCIATED WITH THE AUTO INDUSTRY. TRANSFER OF RESPONSIBILITIES FROM THE

DEPARTMENT OF TRANSPORTATION TO COMMERCE HAS OCCURRED. COMMERCE IS NOW WORKING ON ALMOST A DAY TO DAY BASIS WITH THE TRANSPORTATION SYSTEMS CENTER IN CAMBRIDGE, A RICH SOURCE OF INFORMATION AND ANALYSIS ON THE AUTO INDUSTRY. WITHIN COMMERCE, IN OUR BUREAU OF INDUSTRIAL ECONOMICS, WE ARE EXPANDING OUR AUTO STAFF. WE ARE PREPARING STATUS REPORTS ON INDUSTRY DEVELOPMENTS, LIKE THE ONE SUBMITTED TO THE COMMITTEE, AND WE INTEND TO MAKE THIS A REGULAR PRODUCT. WE HAVE ESTABLISHED AN INTERAGENCY NETWORK TO MONITOR PROGRESS ON THE PRESIDENT'S PROGRAM. AFTER A GOOD BIT OF SEARCHING, WE HAVE SELECTED AN INDIVIDUAL TO HEAD UP THE COORDINATION EFFORT. WE EXPECT TO BE ABLE TO ANNOUNCE HIS NAME VERY SHORTLY.

I AM AWARE THAT THERE ARE INDIVIDUALS WHO WOULD LIKE TO SEE THE GOVERNMENT DOING MORE. BUT IN RESPONSE TO THOSE URGING MUCH DEEPER GOVERNMENT INVOLVEMENT, I WOULD POINT OUT THAT THE RECORD OF THE PAST GIVES LITTLE REASON TO BELIEVE THAT ANY AMOUNT OF GOVERNMENT ASSISTANCE DIRECTED AT AN INDUSTRY CAN MAKE THAT INDUSTRY TRULY HEALTHY AND COMPETITIVE AGAIN. OUR TASKS ARE TO RESTORE THE AGGREGATE ECONOMY TO NONINFLATIONARY VITALITY AND TO ELIMINATE UNNECESSARY IMPEDIMENTS TO INDUSTRIAL PERFORMANCE. WE ARE TACKLING THOSE TASKS. THE REST BELONGS TO MANAGEMENT AND LABOR WITHIN THE AUTO INDUSTRY ITSELF.

Senator DANFORTH. Thank you.
Mr. Olmer?

STATEMENT OF HON. LIONEL OLMER, UNDER SECRETARY OF COMMERCE FOR INTERNATIONAL TRADE

Mr. OLMER. Mr. Chairman, originally I had prepared a statement which would essentially have covered the same ground as the statements which have already been offered and which will follow mine when I conclude. However I would like to spare you the redundancy by taking this opportunity to focus on what is foremost on my mind as we discuss the auto issue in the context of our trading relationship with Japan.

I believe that the trade situation in automobiles and auto parts between Japan and the United States is symptomatic of a larger problem in our trading relationship with that country—that is, the enormous bilateral trade imbalance which, as you pointed out, will exceed $15 billion this year, and by present trends, would easily reach $50 billion by 1990.

In autos and auto parts alone, the U.S. trade deficit with Japan in 1981 will exceed $10 billion. I might add parenthetically that we use a rule of thumb in exporting to the effect that every $1 billion in exports equals about 30,000 jobs. Thus, this deficit in auto trade alone might translate to the total unemployment in the U.S. automobile industry.

Before identifying the root cause of the Japanese surplus, some explanations offered by the Japanese must be dealt with and summarily eliminated. The staggering trade deficits with Japan are not in general the result of a lack of competitiveness by U.S. manufacturers. Even highly competitive U.S. industries are denied access to the Japanese market.

Our deficit is not caused by the strong U.S. dollar or high U.S. interest rates. The growth of the U.S. deficit predates the strong dollar, and Japan is simultaneously running a proportionately larger surplus with the EC, where currencies have been weak.

The deficit is not caused by U.S. apathy in developing the Japanese market. Indeed, the United States has a substantial 34 percent of the Japanese market for manufactured imports. The problem is that Japan does not import much in the way of manufactured goods. We have a large share of a very small pie.

No, these are not the reasons. The fundamental reason for Japan's surplus is a profound inequality in our access to the Japanese economy. This inequality is caused by longstanding Japanese policies and practices which encourage exports and discriminate against imports. It is caused by a pervasive bias against imports at virtually every level of private and governmental decision-making. It can only be solved by timely, effective, and fundamental change in these policies by the Japanese Government.

This is the basic message which Secretary Baldridge and I conveyed to Prime Minister Suzuki and other Japanese leaders on our recent trip to Japan. At that time, we made four key points: First, the imbalance is becoming a political issue which threatens to affect our entire relationship. Second, we do not seek to redress the imbalance through restrictions on Japanese imports, but rather through an expansion of U.S. exports to Japan. Third, the administration and the Congress are equally concerned and united in their insistence on effective Japanese measures. The letter we delivered to Prime Minister Suzuki, signed by 31 members of the House Export Task Force, was an effective expression of the depth of congressional concern, and I would like to provide the committee with a copy of that letter.

[The letter and a status report on the United States automobile industry follow:]

His Excellency
The Prime Minister of Japan

Dear Mr. Prime Minister:

Please accept our greetings and our sincere hopes for the success of your efforts to restore strong and balanced economic growth for Japan and for the entire world. It is in this spirit that we have written to you and have asked Secretary of Commerce Baldrige to convey our concerns to you.

These are fragile economic times, with mounting unemployment and distressed industries around the world. It is in times such as these that nations are more inclined to turn to protectionsim to try to preserve their employment and production levels. We feel a particular obligation to speak out in an attempt to resist protectionism and to allow the forces of free trade and free markets to function to everyone's benefit.

We feel compelled to point out that the rapidly growing Japanese trade imbalance, not just with the United States, but with the entire world, has become a political reality which affects the future of free trade. This imbalance poses a particularly difficult political problem because of the growing concern that the Japanese market is still not fully open to foreign products.

Minister of International Trade and Industry Tanaka made a most welcome statement on July 14, 1981, indicating that renewed attention would be devoted to increasing imports of manufactured goods into Japan. We must regrettably state that substantial actions to implement the policy stated by Minister Tanaka have not yet become evident to us. We hope to stress by this letter, Mr. Prime Minister, the importance which we, the business community, and the public at large have placed on effective efforts by Japan to take positive actions to open its markets fully.

The Government of Japan has taken decisive actions which have eliminated most of the official barriers to imports of manufactured goods. Yet manufactured goods imports into Japan remain comparatively small. As a portion of Japan's total imports, manufactured goods are of smaller significance now than they were in 1978 just after the conclusion of the Strauss-Ushiba Agreement.

Most recently, in fact, there have been indications from Japan that some actions which may be taken to aid distressed industries may also serve to reduce U.S. and other countries' exports to Japan. The United States and many other countries have distressed industries as well as Japan. If Japan, with large and growing trade and current account surpluses, acts to protect distressed industries, how can other governments explain to their unemployed workers in distressed industries why they should not be protected as well?

It is necessary for us to say, Mr. Prime Minister, that it would be particularly difficult for us to explain to our constituents why the United States, which is running a huge trade deficit with Japan and is carrying a heavy international defense burden, should not respond by protecting its distressed industries.

It is for this reason that we take this opportunity to express our hope that the Government of Japan will avoid any actions which would limit American exports to Japan. It is our heartfelt hope that Japan instead will take major initiatives to improve market access for manufactured and other goods imports. Though the short-term adjustment burden of such a course may be higher, this approach would increase Japan's prosperity in the long term.

To be specific, it is our hope that the Government of Japan could take actions to reverse the "buy Japan" policies still prevalent in many parts of the Japanese business community and to take actions which would allow American companies in Japan to be treated in a manner reciprocal to Japanese companies in the United States. We are referring to standards procedures, customs practices, testing requirements, and membership in professional groups or trade associations as examples of way in which Japanese firms in the United States receive more favorable treatment than American companies in Japan.

Secretary Baldrige is aware of our deep sense of urgency in seeking actions which would further free trade rather than protectionism. We hope that our sincere expression of concern will be of assistance to you as well as to President Reagan in helping to chart a trade course which will benefit all our peoples.

Sincerely,

DON BONKER, CHAIRMAN
EXPORT TASK FORCE
U.S. HOUSE OF REPRESENTATIVES

BILL FRENZEL, VICE CHAIRMAN
EXPORT TASK FORCE
U.S. HOUSE OF REPRESENTATIVES

SAM GIBBONS, CHAIRMAN
SUBCHAIRMAN ON TRADE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

UNITED STATES AUTOMOBILE INDUSTRY

STATUS REPORT

OVERVIEW

Sales of domestic-made automobiles are down a third from the 1978 peak. Sales of imports are up 15 percent from 1978. There is no prospect for a sharp turnaround in the immediate future. Cyclical factors only partially account for industry difficulties. A fundamental shift downward in the long run demand for automobiles, and some categories of trucks, has also become evident and can be expected to continue. Domestic producers are not cost competitive with Japanese producers.

Poor sales have resulted in losses for the auto manufacturers. More important, they have resulted in large negative cash flows for the auto companies. The erosion of the financial strength of the auto companies is best illustrated by the combined working capital position of the Big four (GM, Ford, Chrysler, and AMC), which has fallen from $13 billion at yearend 1978 to $300 million at the end of the third quarter of 1981.

Given the severe cash flows pressures, the auto companies may be forced to pursue any of the following actions:

- Postponements of modernizing investments.
- Shutdowns of excess capacity.
- Increases in foreign sourcing.
- Curtailments of wage gains.
- Infusions of large external financing.

There are ample signs that the companies are already pursuing combinations of these approaches. Although the analysis in this report suggests that all these steps may be required to preserve industry liquidity, the question remains whether the industry can do this and restore long-run competitiveness at the same time. A revived economy is the only change that can be realistically expected to remedy the industry's condition. And, even then, reduced demand growth will make it difficult for domestic producers to return to the sales and profit years of decades past. Pressure to find new jobs for displaced auto workers can be expected to persist.

RECENT TRENDS IN INDUSTRY PERFORMANCE

SALES

New Cars

Following severe declines in 1979 and 1980, new passenger car retail sales will drop another 3 percent in 1981 to an estimated total of only 8.7 million units. (See Exhibit 1.) From the 1978 peak, new car sales will end 1981 down 22 percent. Sales of domestically-produced cars are being particularly hard hit, falling to about 6.3 million units for the year, a drop of 31 percent from the 1978 peak.

Reflecting a combination of uncertain economic conditions, high interest rates, and high car prices, sales of domestic-make cars have been sluggish all year, save for two periods (Feb.-Mar. and Aug.-Sept.) when manufacturers offered rebates and other incentives. Although industry analysts earlier expected the new car market to begin a recovery in the fourth quarter, it is now apparent that the long awaited upturn will occur no earlier than late winter or early spring. To counter the weak market, manufacturers have been offering a series of sales incentive programs. Incentives so early in a model year are unprecedented.

In contrast to domestic-make car sales, imported car sales have been at or near record levels since the sharp rise in gasoline prices in 1979. Import penetration, at 17.9% of the market in 1978, reached 26.7 percent in 1980. Peaking at 29.6 percent in July, import penetration will average an estimated 26.5 percent for 1981. (See Exhibit 2.) The share would have been higher this year had Japan not imposed export restraints on its car manufacturers. Japanese products have dominated the import market since 1979, consistently accounting for about 80 percent of imported car sales. Because of the general weakness of the auto market and Japan's export restraint program, import sales are expected to decline 4 percent from last year's record level to a total of 2.3 million cars for 1981.

NEW CAR SALES

	Domestic	Import	Total	Import Market Share
	(---Millions of Units---)			
1978	9.2	2.0	11.2	17.9%
1979	8.2	2.3	10.6	22.1
1980	6.6	2.4	9.0	26.7
1981 Estimate	6.4	2.3	8.7	26.5

<u>New Light Trucks</u>

Economic conditions have depressed truck sales as well. In addition, the personal transportation segment of the truck market, which accounted for a substantial portion of light truck sales during the late 1970's, has virtually disappeared, due to poor fuel economy performance. As a consequence, over the last two years, domestic-make light truck sales have been even more severely depressed than passenger car sales. (See Exhibit 3.) For 1981 sales of domestic-make light trucks will be an estimated 1.6 million units, down 8 percent from 1980 and down 53 percent from the 1978 peak. For 1981 total light truck sales, including imports, are projected at 2,050,000 units, 7 percent less than last year and 45 percent below the 1978 peak.

As with passenger cars, sharply rising fuel prices have generated an unprecedented demand for the mini-pickup trucks produced in Japan. (See Exhibit 4.) Import penetration has risen from 9 percent of the light truck market in 1978 to an estimated 22 percent for 1981, despite the tariff reclassification last year that increased the import duty from 4 to 25 percent.

SHIFT TO THE SMALLER CAR

One of the most noteworthy developments in recent years has been the dramatic shift of consumer demand to smaller, more fuel-efficient cars. (See Exhibit 5.) Small cars (subcompacts and compacts, including imports) accounted for 47 percent of total new car sales in 1978. Their market share increased to 55 percent in 1979 and 62 percent in 1980 and will reach an estimated 64 percent in 1981. The share for small cars now appears to be leveling off, however, with considerable uncertainty as to the future trend.

Domestic car producers were not prepared for the abrupt shift in consumer preference to smaller cars. When the change began in earnest in the spring of 1979, only two families of domestically-produced "new design" small cars (front wheel drive) were available -- General Motors' recently introduced X-car and Chrysler's Omni-Horizon. Lacking production capacity for "new design" small cars, domestic manufacturers lost substantial market share to imports during 1979 and 1980. Since 1979, the domestic industry has introduced additional new small models and converted substantial production capacity to their manufacture. The companies, therefore, now have capacity to produce 4 million "new design" small cars annually, compared to a 1981 annual sales rate of only about 2.1 million units. (See Exhibit 6.)

SALES PERFORMANCE BY COMPANY

Market share losses to imports have not been evenly distributed among domestic producers. Since the 1976-78 period, Chrysler and Ford have incurred major share losses, while General Motors' loss has been relatively modest. Following the introduction of its compact K-cars a year ago, Chrysler has recovered approximately a third of its loss. For 1981, General Motors' market share will be 2 percentage points below its 1976-78 average; Ford's, 6 percentage points lower; Chrysler's, 2.5 percentage points lower; and American Motors', 0.3 percentage points lower. In contrast, the importers' market share will be about 9.5 percentage points higher.

MARKET SHARE
(Percent of Total New Car Sales)

	GM	Ford	Chrysler	AMC	VW	Imports	Total
1976-78 Average	47.0	22.6	11.3	1.9	0.1	17.1	100
1979	46.0	20.0	8.9	1.5	1.5	22.1	100
1980	45.8	16.4	7.4	1.7	2.0	26.7	100
1981 Estimate	44.9	16.4	8.7	1.6	1.9	26.5	100

PRODUCTION

Sluggish sales and high inventories have restrained domestic output over the last several months. Production schedules have been cut back repeatedly to regain control of inventories. Based on current schedules, domestic production for 1981 will total a disappointing 6.3 million cars, 1.6 percent below last year's output, and the lowest since 1961. Domestic light truck production is no more promising, with only 1.55 million units scheduled for assembly this year. Although 11 percent above a year ago, 1981's light truck output will be 53 percent below the 1978 record.

INVENTORIES

Dealer inventories of new cars skyrocketed in the spring of 1979, with unit stocks reaching an all-time peak of 2.1 million vehicles by the end of June. The industry managed to reduce inventories over the following 21 months, as dealer stocks dropped to a low of 1.2 million in March, 1981. (See Exhibit 7.) However, inventories again went out of control during the second quarter of 1981, when car production exceeded retail sales by 0.4 million units. Although dealer stocks were reduced during the summer of 1981, the October month-end inventory represented an 81 selling days' supply of cars, compared to the normal level of 50 to 60 days. With a bleak fourth quarter sales outlook, inventories will continue to be a drag on production.

EMPLOYMENT AND UNEMPLOYMENT

Since late 1979, unemployment has been widespread in the industry. Unemployment peaked in August 1980 with 250,000 production workers -- 32 percent of the hourly work force -- and 50,000 salaried workers indefinitely laid off by the car manufacturers. (See Exhibit 8.) At the same time, unemployment among domestic parts and component manufacturers, and other automotive suppliers, reached an estimated 650,000.

Though still a critical problem, unemployment in the motor vehicle manufacturing industry is not as severe as a year ago. Over 70,000 production workers have since been recalled by the auto manufacturers. The number on indefinite lay-off as of November 16 was 179,000. By early December indefinite layoffs are expected to reach 193,000. Still, total U.S. employment (including salaried personnel) of the five car companies is currently only 752,000, compared to an all-time peak of 1,033,000 in the fourth quarter of 1978.

The probability of automotive employment ever recovering to its 1978 peak is low. At that time, the U.S. auto industry directly employed approximately 1 million workers with an additional 1.4 million employed by the automotive supplier industry. Based on current projections of slow growth in domestic automotive demand and assuming the productivity gains required for regaining international competitiveness, the automotive industry, in comparison with the 1978 peak, will employ approximately 200,000 fewer workers in the mid-1980's. The supplier industry may suffer an employment loss in the range of 300,000 to 400,000 workers from the 1978 total.

In addition to the motor vehicle manufacturers and their suppliers, franchised dealers have also been severely affected by the depressed automotive market. Since 1979, 2,600 new car dealerships -- 10 percent of the total -- have closed; approximately 100,000 dealer employees have been laid off.

Exhibit 9, which shows employment by company for the auto manufacturers since 1978, illustrates most notably the declines in employment at Ford and Chrysler. Exhibit 10, which shows employment trends in the seven top auto producing states, demonstrates that, since the 1978/1979 period, Michigan and Ohio have absorbed about two-thirds of the employment decline in auto manufacturing.

WAGES

Including fringe benefits, average earnings of production workers at the major auto manufacturing companies, other than Chrysler, are now around $19 per hour. Excluding fringe benefits, September 1981 hourly earnings of production workers in the motor vehicle industry averaged $11.01, 35 percent above the level for all manufacturing.

A comparison of compensation rates in the U.S. auto industry with those of other auto producing countries indicates that, on average, only West German auto workers appear to earn more than U.S. workers. Recent studies of comparative wage and fringe benefit costs for U.S. and Japanese auto production workers indicate that in 1980 the Japanese advantage was from $7.80 to $8.60 per hour. Moreover, these figures ignore the higher productivity of Japanese workers. Thus, the difference in hourly unit labor costs is even greater.

The industry's labor contracts expire in September 1982. While there are indications of a widening recognition of the need to restrain wage increases in the face of strong import competition, it is premature to speculate on the outcome of the negotiations.

PRICES FOR NEW CARS

Quarterly and annual movements in the BLS and BEA price indexes for new cars from 1978 through the third quarter of 1981 are shown in Exhibit 11. Over this period new car prices increased by 48 percent according to BEA data and 29 percent according to BLS data.

In interpreting these price movements, it is important to know some of the basic conventions used to construct the BLS and BEA price indexes. Each measure has limitations as an indicator of price movements. Both the BLS and BEA price indexes represent true transaction prices, in that dealer discounts and manufacturers' rebates are reflected in the price indexes. 1/ However, in the BLS index the costs of quality improvements

1/ It is important to note, however, that the recent sales incentives via interest rate subsidies, as for example, the General Motors plan offering new car loans at a 12.9 percent annual interest rate, is not reflected in the new car price index. Rather, it is reflected in the auto finance component of the CPI.

are "factored out" and, thus, it understates the actual increase in new car prices that has occurred in the past several years. BEA data include quality improvements in prices. However, even the BEA price index understates the true "sticker shock" effect that may face new car buyers. The BEA index reflects the changing mix of cars purchased, and insofar as the small car share of total auto sales has risen from around 49 percent in 1978 to around 65 percent in 1981, this has helped moderate the rise in the average transaction price.

An interesting fact that emerges from an examination of the BEA data is the relative levels and movements in the prices of domestic vs. imported cars. (See Exhibit 12.) Over the period quarter I 1978-quarter III 1981, average prices of domestic cars increased 44 percent, considerably less than the near 66 percent increase in the average price of imported cars. During 1978-1980, average prices for imported cars were lower than those of domestic cars; but in the first quarter of 1981 this picture reversed itself, when domestic car prices barely increased due to widespread rebate programs, while those of imported cars increased by 8.7 percent.

Comparisons of imported and domestic car price movements for the second and third quarters of 1981 present a mixed picture, with average unit values of imported cars rising much more than those of domestic cars in the second quarter but considerably less in the third quarter. In the third quarter of 1981, domestic car prices averaged $8,988 and imports $9,125.

The rapid rise in imported car prices during 1981 has occurred despite depreciating yen and Deutsche Mark exchange rates relative to the dollar (Japan and West Germany accounted for 92 percent of import sales for the first ten months of 1981); since the first of the year, the yen has fallen almost 12 percent and the Deutsche Mark 10 percent against the dollar. The 1981 increase, to a considerable degree, reflects the upgraded product mix and option-loading of cars shipped to this country by Japanese manufacturers and the halting of price discounting by their U.S. dealers in response to Japan's export limitation policy.

Sharply increasing costs of automobile ownership and operation, together with volatile economic conditions, have increased the price sensitivity of the new car market since 1979. Price increases have been followed by periods of reduced volume, and price discount programs have stimulated sale increases.

Thus manufacturers face a dilemma: Price hikes adequate to recover higher production costs drive down sales volume to near breakeven levels or below. How manufacturers will respond to the pricing quandary in 1982 is uncertain at this time. General Motors and Ford set price increases at 5.8 and 4.7 percent, respectively, on their 1982 models. Cash-starved Chrysler, after first announcing a hike of 7.7 percent, then rolled back its increase to 3.7 percent. However, all three companies have resorted to sales incentive programs since introducing their 1982 models.

INTEREST COSTS

High interest rates are often identified as a major deterrent to new car sales. Potential buyers certainly consider rates and total interest charges as part of the purchasing decision. Calculations from figures in Exhibit 13 indicate that these interest costs increased by 76 percent between the first quarter of 1978 and the third quarter of 1981. However, the magnitude of the monthly payment tends to be the more important consideration. In this regard, average new car payments as a percent of disposable personal income per household declined slightly from 1978 to 1980, in spite of car prices averaging 48 percent higher and auto loan interest rates increasing from 13.0 to 16.0 percent during this period. The rise in monthly payments was somewhat constrained by an increase in loan duration from 42.9 to 45.1 months. Although higher this year than in 1980, car payments as a percent of disposable personal income per household are lower than in 1976 and 1977, when the new car market was healthy. Even though interest rates may not be the primary factor affecting new car purchase decisions, they do have an adverse psychological impact on prospective buyers and also result in lending institutions being more restrictive with their funds. The disqualification rate for new car loans has been higher than normal in recent months.

FINANCIAL PERFORMANCE

Revenue of the Big four automakers fell from $122 billion in 1978 to $106 billion in 1980, recovering only to an estimated $111 billion in 1981. Over the same period net income fell from a profit of $5 billion in 1978 to a $4.2 billion loss in 1980 and an estimated loss of $1.4 billion in 1981. The estimate of 1981 net income is heavily dependent upon assumptions concerning tax credits. In the third quarter of 1981 tax credits of $700 million significantly reduced the size of the net income loss.

Since 1978, cash flow pressures have been intense. The Big four experienced negative cash flows of $2.5 billion in 1979 and $9.1 billion in 1980. Depending on assumptions for the fourth quarter, the 1981 cash flow could be negative by as much as $6.4 billion. The most startling trend of all is the drastic rundown in the working capital of auto producers. At yearend 1978 their combined working capital was $13 billion; at the close of the third quarter of 1981 their actual working capital was $300 million; by the end of 1981 they could be showing, combined, a zero working capital Under pessimistic assumptions it could fall to a negative $900 million.

Standard financial ratios for the combined position of the Big four show parallel trends. For example, the quick ratio (curent assets less inventories/current liabilities) was 0.9 in 1978; by the third quarter of 1981 it was down to about 0.5. During the same period, debt as a share of debt plus equity increased from 15 to 30 percent.

Not surprisingly, the financial performance of suppliers, within the auto related end of their businesses, has declined along with that of the auto manufacturers. For U.S. based supplier firms, auto related operating incomes as a share of auto related sales were cut in half during the 1978-1980 years.

INVESTMENT

Estimates for the total cost of the 1978 through 1985 changeover for the United States/Canada operations of the domestic motor vehicle industry, including start-up costs, run around $65 billion. The Transportation Systems Center (TSC) estimates that roughly half of this investment program has now been completed. As this report makes clear, however, severe cash flow pressures could force the auto manufacturers to postpone completion of the second half of the program. In recent months announcements of investment stretchouts or postponements have become regular features in the auto trade press.

A recent survey among machine tool manufacturers suggests that cancellations by the auto producers will amount to a loss of $1.5 billion to $2.0 billion in machine tool business. New orders for automotive machine tools are currently running at no more than 50 percent of their level in 1980.

GLOBAL CAPACITY AND UTILIZATION RATES

Currently, annual global capacity to produce cars and trucks (both light and heavy) is estimated at about 48 million units, with slightly under 30 percent of the capacity sited in North America. With 1980-1981 production running around 38 million units, the global capacity utilization rate during the last two years has been hovering about 80 percent. Considerable disparity exists, however, in the level of capacity utilization throughout the world. Capacity utilization in North America, at 70 percent, falls below that for any other geographical area. Japanese producers have been operating at 100 percent, Latin American producers at about 95 percent, and West Europe producers at about 75 percent. More importantly, of the 10 million unit excess production capacity estimated for 1980-1981, close to half is sited in North America. (See Exhibit 14.)

BASIC CAUSES OF THE INDUSTRY'S PROBLEMS

Unlike the previous automotive recessions, the present slump is not entirely cyclical in nature. In addition to cyclical influences, the downturn in domestic-make sales also reflects an apparent slowdown in the long-term growth rate of demand for automobiles together with the impact of sharply intensified international competition for the U.S. market. The slower growth rate for automotive demand results from demographic factors, the erosion of consumer purchasing power by inflation, and the sizeable increase in the relative price of owning and operating a car.

DEMOGRAPHICS

The recent decline in the growth rate of the driving age population has slowed the growth of automotive demand. Between 1979 and 1980, the growth rate of persons aged 18-24 (which includes many first-time car buyers) was less than half of the 2.3 percent annual growth rate between 1970 and 1975. Moreover, the number of people in this age group will actually decline by 1985.

CONSUMER PURCHASING POWER

The rate of increase in consumers' real income has slowed markedly over the past five years. Moreover, because prices for food, energy, and shelter have increased at a more rapid pace than other items, the squeeze on discretionary real incomes has been even more pronounced. Improvement in real incomes is critical to the restoration of a more normal level of car buying.

Over the period 1971-1980, consumers spent a relatively constant share of their total expenditures on owning and operating automobiles. (These outlays include purchase of new and used cars, gasoline and oil, insurance, financing costs, repair, leasing, and other service fees.) The automotive-related share varied from a low of 11.9 percent of Personal Consumption Expenditures in 1970 to a high of 13.8 percent in 1977. (See Exhibit 15.) During the first half of 1981, the share was 13.2 percent despite depressed new car sales--a consequence of rapidly rising costs of financing, insuring, maintaining, and operating a car. Since January 1978, these costs have increased by 70 percent--more than double the 34 percent increase in new car prices. (See Exhibit 16.)

Higher gasoline prices, which have increased annual fuel costs almost $500 per car since 1972, have an additional effect on long-term automotive demand. In response to higher gasoline prices, consumers are changing their driving habits. The average number of miles driven per year has dropped from 10,184 miles per car in 1972 to an estimated 9,400 miles in 1980. The reduced usage of cars can be expected to lead, ultimately, to lower replacement demand.

CONSUMER PERCEPTIONS

Consumer perceptions of the quality of domestic cars relative to imports, in particular Japanese-produced vehicles, are undoubtedly an important factor in the current domestic car sales slump. Several recent consumer attitude surveys show consistently higher quality ratings for imports. A poor quality image is difficult to turn around and the shift unfortunately requires an extended period of time. Quality is fundamentally a question of the priority which management and labor are willing to assign to it. There is considerable evidence that both groups now recognize its importance to the industry's recovery. Achievement of quality levels competitive with imports--and consumer recognition of this condition--is certainly imperative for domestic industry recovery.

INTERNATIONAL COMPETITIVENESS

Lack of competitiveness in manufacturing costs threatens the U.S. auto industry's long-term viability and is its most difficult challenge. Japanese manufacturing costs are substantially below U.S. costs for a comparable car, due to lower hourly compensation, productivity advantages from a more advanced manufacturing technology and more effective systems for controlling inventory, product quality, and workplace activity. Recent studies indicate Japanese manufacturers can land cars in this country for as much as $1,000 to $1,500 per car less than U.S. producers can deliver comparable vehicles to the same destinations.

One means by which auto manufacturers are trying to reduce costs and become more competitive is through increased foreign sourcing. TSC closely monitors projected foreign sourcing plans of the domestic auto manufacturers. Based on what the companies have publicly announced over the last year or so, TSC estimates that during the 1982-1984 period, in any single year, the domestic producers may be drawing on foreign sources for the following quantities of auto components:

Item	Million Units
Engines	2.5
Transaxles	1.7
Aluminum cylinder heads	1.3
Alternators/starters	1.5
Wiring harnesses	5.0
Rear disk brakes	.5
Constant velocity joints	.6

It should be noted that the above figures stand totally apart from traditional imports of replacement parts for both U.S.-made and imported vehicles. Rough estimates of what the above list might add up to in dollar terms give a figure of $2.5 billion.

A substantial portion of the industry's current investment program involves the modernization of manufacturing facilities to achieve the productivity improvements necessary for regaining international competitiveness. The eventual success of this program, which is planned for completion by the mid-1980's, is difficult to predict, particularly in view of the unfavorable near term cash flow outlook and the already announced postponement of some investment plans. In addition, the Japanese industry will not be standing still during this period and can be expected to enhance its competitive position with further product and manufacturing advances.

INTERNATIONAL TRADE ISSUES

Export Restraint

On May 1, 1981 the Japanese government announced that it would restrain auto exports to the United States for a period of two and possibly three years. This decision was clearly based on the Japanese government's perception of the growing protectionist sentiment in this country and its recognition of the impact of the weak state of the auto industry on the U.S. economy.

For the first year of the restraint program, beginning April 1981 through March 31, 1982, the Japanese indicated their auto exports to the United States would be limited to 1.68 million units using Japanese Automobile Manufacturers' Associaton (JAMA) data. Because JAMA data does not include export to Puerto Rico or certain "car-derived vans" (similar to station wagons), separate measures were taken later to restrain these exports. The Japanese announced that for the first restraint year exports of "car-derived vans" would be limited to 82,500 units, and passenger cars and vans to Puerto Rico would be limited to 70,000 units.

The Commerce Department's monitoring system shows that during the first six months of the first restraint year (April-September, 1981), about 905,000 passenger cars were shipped to the United States according to JAMA data. This represents nearly 54 percent of the 1.68 million units for the first restraint year. We have every reason to believe the Japanese will fulfill their commitment under the first year of the restraint program.

For the second year, the Japanese government indicated its intention to adjust the 1.68 million unit level by 16.5 percent of the estimated increase in aggregate sales in the U.S. market above total sales in the first year of the restraint. The Japanese are to make the market estimates. To date, the Japanese have not indicated the forecast which they will use to calculate the export restraint level for the second year. This matter will be discussed with the Japanese government at meetings in early December.

At a minimum, exports will be monitored during the third year. The Japanese government has indicated that the restraint and monitoring will not be extended beyond three years and will end on March 31, 1984.

Auto Parts

In May 1980 the Japanese government presented to the United States a statement of understanding between the two countries concerning a broad range of automobile issues. As part of this statement, Japan agreed to eliminate tariffs on auto parts and to support an auto parts purchasing mission.

Purchasing Missions

In September 1980, the Department of Commerce sponsored the Japanese auto parts buying mission to the United States. This month we also sponsored an auto parts selling mission to Japan. The Department, through its Trade Facilitation Committee, is conducting a two year program to monitor the results of the missions, and to pursue ways to increase sales of U.S.-made auto parts to Japan and in the U.S. aftermarket (replacement) for Japanese cars.

Through the Trade Facilitation Committee, Commerce obtained a $300 million target for Japanese purchases of U.S.-made auto parts in 1981. This commitment was based on an understanding of the need for open markets in both Japan and the United States. However, the Japanese now state that their commitment was based on the assumption of open U.S.-Japan trade in automotive products and that the May 1 announcement of the unilateral export restraint on autos makes that commitment difficult to achieve. Commerce will meet with the Japanese in December to review the disappointing progress made toward the $300 million target, and to secure a Japanese commitment to ongoing means of increasing U.S. auto parts sales to Japan and in the U.S. aftermarket for Japanese-made cars.

Tariff Reductions

On April 1, 1981, the Japanese eliminated tariffs on some 38 auto parts categories and reduced the tariff on one other category. With the major exception of carpeting, these tariff cuts were responsive to U.S. requests. Since that time, U.S. auto parts producers have made additional requests for duty elimination on some eight 7-digiit tariff items, including carpets. The Administration is currently pressing for the elimination of Japanese tariffs on these additional auto parts.

OUTLOOK

Commensurate with the uncertain outlook regarding length and the depth of the current recession, forecasts of 1982 U.S. new car sales currently vary widely. Three months ago most forecasts fell within the 10.0 to 10.5 million range; currently the forecasts are between 9.0 to 9.5 million cars, including 2.3 to 2.4 million imports. The outlook is for continuing heavy cash flow pressures on the domestic industry until late 1982. Industry analysts are still expecting the recovery to generate high volume sales in 1983 and 1984.

Although the pressures on cash flow will ease as the industry recovers from the recession, profits may still be relatively low and financing of investment difficult. The larger-size cars and the luxury models have historically had higher profit margins, while small cars generally have had low and, in some instances, negative margins. Average profit margins will tend to be held down as small cars increase their market share. This situation reflects the influence of import pricing which, to a considerable degree, controls domestic small-car pricing. To achieve some degree of profitability in the small-car business, domestic manufacturers will promote optional equipment and introduce small luxury and specialty models. During the 1980's, manufacturers will face a major challenge in developing and producing a fleet of cars with a product mix that can provide an adequate return on investment.

REVIEW OF THE AUTOMOBILE INDUSTRY PROGRAM

On April 6 the President announced a six step program for the U.S. automobile industry. The steps and actions to date are summarized below.

(1) Economic recovery. Creation of a stronger and more stable economy will be the core of the program.

Actions: The President's Economic Recovery Program went into effect on October 1. The business tax provisions of the Program, retroactive to January 1, will have the following estimated effects on the motor vehicle industry. For tax depreciation purposes the average tax life of buildings will be reduced from 35 years to 15 years; for equipment the reduction will be from 9.5 years to 5 years. Previous tax law was equivalent to about 90% of immediate expensing; the new tax law, assuming the industry earns sufficient income against which to charge deductions and credits, will approximate immediate expensing. Again assuming the industry can take full advantage of the new tax provisions, the industry's after tax rate of return should be increased by about 1.5 percentage points.

Ford has already indicated its intention to take advantage of the leasing provisions in the new tax law. In exchange for a lease back of equipment, Ford expects to sell IBM about $1 billion of its accumulated tax credits and depreciation deductions, generating, thereby, something on the order of $100-$200 million in cash for Ford. Chrysler, in a similar arrangement with General Electric, intends to sell tax credits and depreciation deductions on $150 million worth of equipment, realizing $26 million on the transaction.

(2) Regulatory Relief. A total of 34 regulations identified by the Environmental Protection Agency (EPA) and by the National Highway Traffic Safety Administration (NHTSA) will be revised, rescinded, or reproposed. The Task Force on Regulatory Relief will consider additional regulatory changes.

Actions: At the time of program announcement, EPA and NHTSA estimated that over the next five years these actions would save the auto industry more than $1.3 billion in capital that could be used for other purposes such as plant modernization.

Eight EPA actions (out of 17) and eight NHTSA (out of 17) have been completed. A review of the incomplete data on potential savings from this regulatory relief indicates that roughly 45% ($585 million) of the expected $1.3 billion capital savings will be achieved by the changes implemented thus far. How much of these savings will occur in the next 12 months is not known. Some of the regulatory changes will have an immediate effect on motor vehicle production costs in the current model year, while other changes will not affect models until several years in the future. Thus, regulatory relief, while important, cannot be expected to provide substantial assistance to overcome the industry's short-run financial problems. The status of each of these actions is as follows:

<u>IMPLEMENTATION ACCOMPLISHED</u>
(Final rule issued or administrative action taken)

<u>Environmental Protection Agency</u> (8)

Adopt a self-certification program for vehicles to be sold at high altitude.

Forgo assembly-line testing at high altitudes.

Initiate consolidated NO_x waiver proceedings for light-duty diesel-powered vehicles.

Initiate consolidated CO waiver proceedings for light-duty vehicles.

Do not require use of onboard technology for the control of hydrocarbon emissions resulting from the fueling of motor vehicles.

Streamline the motor vehicle certification program.

Reduce the annual number of assembly line test orders.

Explore deferring standards for paint shops.

<u>National Highway Traffic Safety Administration</u> (8)

Delay implementation of first phase of "208 Standard" (passive restraints for large cars, model year 1982).

Rescind requirement for manufacturers to install automatic occupant restraints, e.g., air bags or automatic belt systems to protect all front seat occupants, beginning in Model Year 1983 (passive restraints for all cars).

Rescind the "Fields of Direct View" requirements for passenger cars.

Terminate rulemaking on "Fields of Direct View" for trucks, buses and multipurpose passenger vehicles.

Withdraw the ANPRM on post-1985 fuel economy standards.

Propose a one-year deferral of the effective date of the Theft Protection Standard and deletion of the key removal provisions.

Propose termination of the rulemaking on Low Tire Pressure Warning Indicators.

Terminate rulemaking on design testing and labeling of batteries.

IMPLEMENTATION NOT YET COMPLETED
(Initial actions taken or expected by early 1982)

Environmental Protection Agency (8)

Revise the statutory HC and CO standards for heavy-duty trucks to a level that would not require catalysts.

Relax the 10 percent Acceptable Quality Level to 40 percent for assembly-line testing of light and heavy trucks.

Delay assembly-line testing for heavy-duty engines.

Relax the statutory NO_x emission limits for heavy-duty engines.

Institute NO_x emission averaging for light and heavy trucks.

Institute emission averaging for diesel particulate emissions.

Adopt equivalent non-methane hydrocarbon standards as an options for all vehicles.

Relax test vehicle exemption requirements.

National Highway Traffic Safety Administration (9)

Modify the existing bumper standard to meet the statutory requirements that such a standard be as cost effective as possible.

Amend the regulation creating the uniform Tire Quality Grading System.

Amend the regulation on safety belt comfort and convenience.

Terminate rulemaking on safety problems associated with multiple rims on trucks and buses.

Rescind the standard on speedometers and odometers.

Propose modifications to the recently issued Hydraulic Brake Performance Standard for light trucks, buses and vans.

Propose eliminating information requirements on Tire Reserve Load, and reducing the minimum advance notice required before tire production may start.

Streamline and reduce fuel economy reporting requirements.

Propose changing Federal Vehicles Identification Number requirements from a Federal Motor Vehicle Safety Standard to an administrative regulation.

IMPLEMENTATION UNCERTAIN

Environmental Protection Agency (1)

Eliminate the 1984 high-altitude requirement. (Legislative action is included in the Administration's proposed Clean Air Act amendments).

(3) Worker assistance. The Department of Labor will propose revisions in its programs to make more effective use of assistance to unemployed auto workers.

Actions: Title XXV of the Omnibus Budget Reconciliation Act of 1981 amended the Trade Adjustment Assistance program, reorienting the program towards placement and employment services and emphasizing benefits such as training, job search, and relocation. The amendments became effective October 1.

Assuming additional funding (an issue yet to be resolved), unemployed auto workers could apply for increased training and reemployment assistance. The amendments, however, also reduce the weekly cash assistance level to that of applicable state unemployment insurance programs, with reduced duration as well. Further, newly employed auto workers, who qualified under the prior program, are not eligible under the amended program because of changes in duration and eligibility requirements, changes put in place to target the program to the long term unemployed.

Starting in August 1980, the Department of Labor began an experienced worker demonstration project in Wayne County, Michigan. In phase one of the project about one-third of the workers offered training, job search, and relocation assistance took advantage of the program. Of these, about 60% were placed in new jobs. In October 1981, a second phase of the project received $3.8 million in federal funding for operation through December 1982. About 5,400 more workers facing layoffs could be assisted by this program.

(4) Accelerated government purchase of automobiles. The U.S. Government will spend about $100 million more during FY 1981 for the purchase of automobiles.

Actions: GSA's initial budget proposal contained a line item for $100 million for accelerated purchase of cars and trucks by the Federal Government. The request was denied in the House and the Senate. GSA contacted the Senate Appropriations Committee, appealing on the grounds that the item was part of the auto industry program. The appeal was denied. No further action was taken.

(5) Lifting specific antitrust prohibitions. Pending related action in the Court of Appeals, the Attorney General will seek the lifting of certain prohibitions against cooperative ventures and joint presentations before regulatory agencies.

Actions: On June 29, after the issue had been remanded from the Court of Appeals back to the district court level, the Department of Justice advised the district court that the government wished to withdraw its motion to extend provisions prohibiting auto manufacturers from exchanging confidential information (relating to emission control devices) and from submitting, in the absent of a request, joint statements to any governmental body with responsibility for establishing automobile emission control and safety standards. On August 3 the court agreed.

In addition, Justice has decided to seek Court modification of a 1969 judgment (the "Smog Decree") in order to permit the companies to engage in, should they wish to do so, research joint ventures that would be lawful under the antitrust laws but are prohibited by the judgment.

Further, Justice is presently reviewing three early 1950 judgments regulating relationships between Chrysler, Ford and GM and their respective credit company affiliates. Depending on review findings, Justice may seek modification or termination of the judgments, thereby lifting impediments to competition in auto financing.

(6) Import monitoring. The government will monitor the effects of international trade on the domestic automobile industry.

Actions: On May 1, 1981, Japan's MITI announced that it would take measures to restrain the volume of passenger cars exported to the United States during the next three years, starting with Japan's fiscal year commencing April 1981. Late in June MITI allocated the export limits to individual Japanese producers.

In collaboration with the Japanese Government, the Department of Commerce resolved technical issues relating to car classifications, differences between Japanese and U.S. auto trade data, and differences in treatment of shipments to Puerto Rico. Commerce issued its first monitoring report in October, providing data on U.S. imports of Japanese exports from April onward.

For the first six months of the first restraint year (April-September, 1981), about 905,000 passenger cars were shipped to the United States according to Japanese Automobile Manufacturer Association (JAMA) export data. This represents nearly 54% of the 1.68 million limit for the first restraint year. To avoid exceeding the limit, Japan will have to export 130,000 fewer automobiles in the second half of the restraint year.

Exh'' '' 1

MONTHLY UNIT RETAIL SALES OF NEW PASSENGER CARS

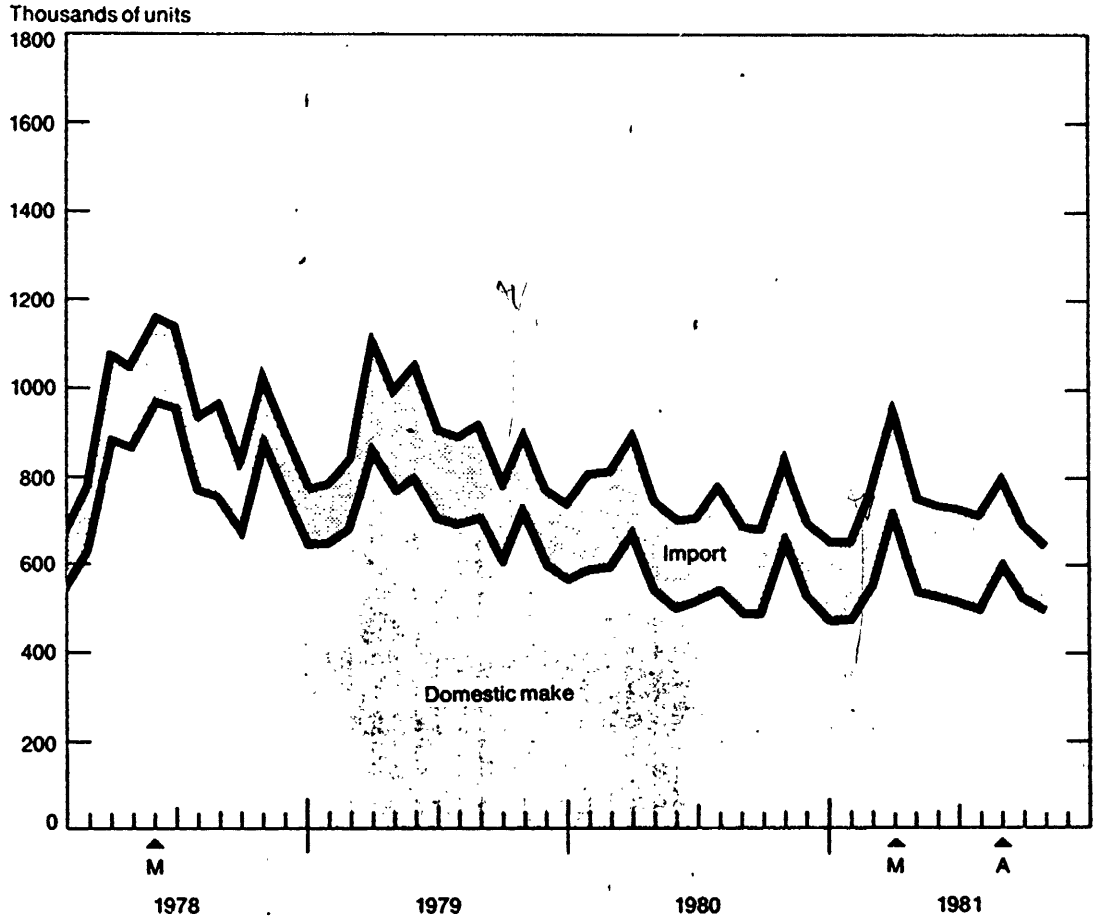
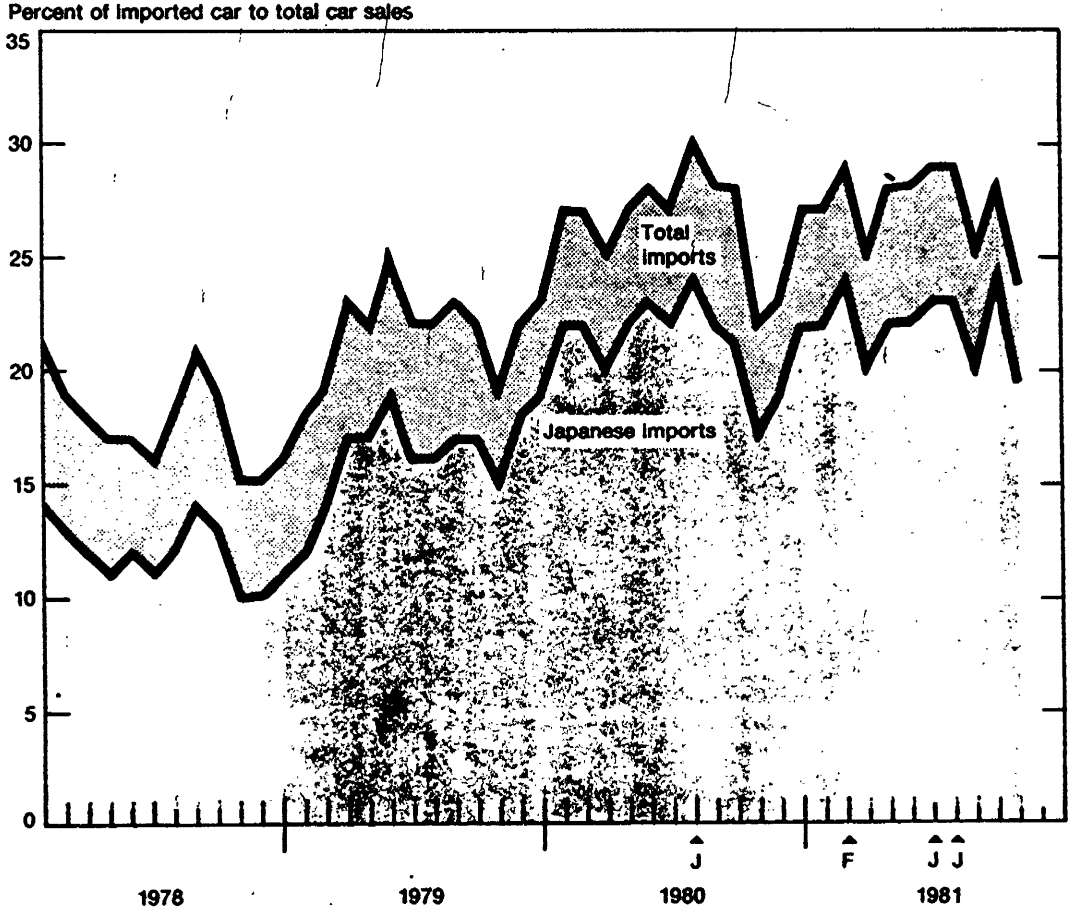


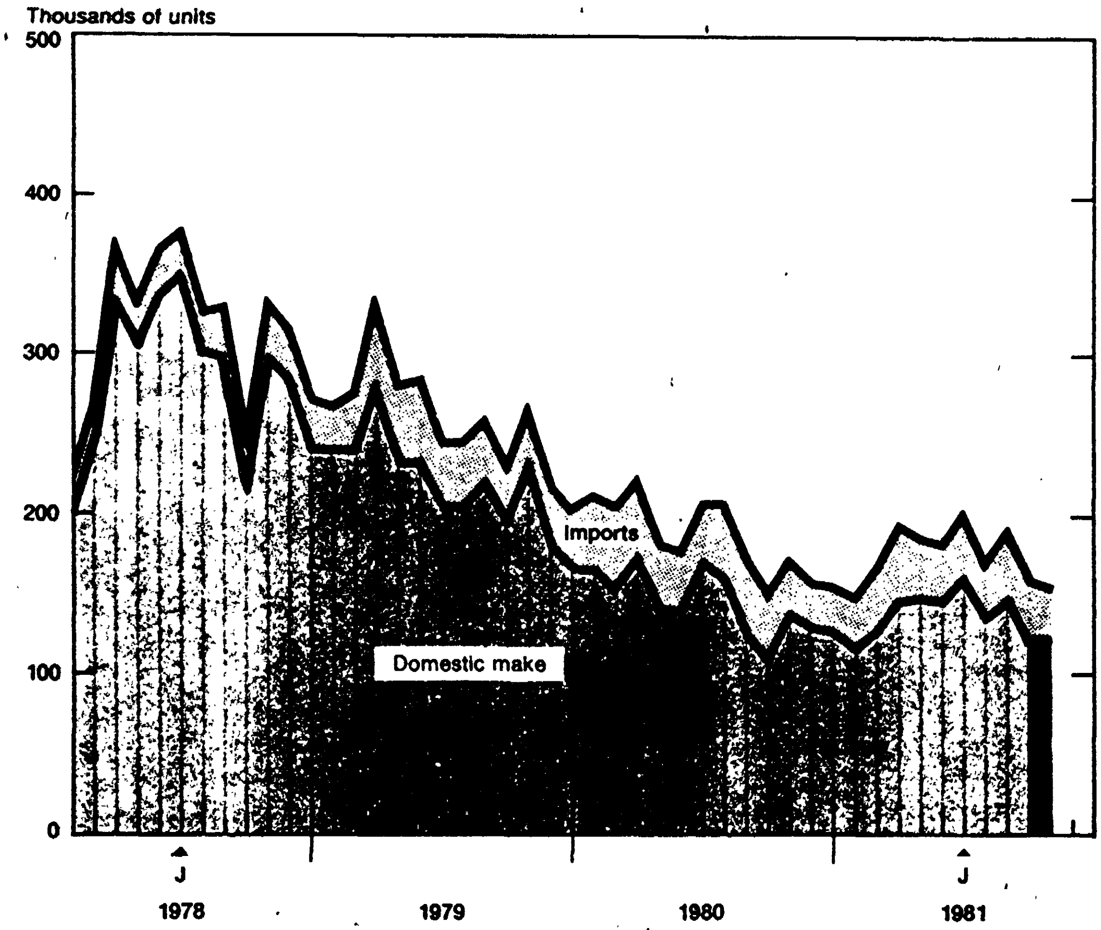
Exhibit 2

IMPORT PENETRATION OF U.S. NEW CAR MARKET



Exh 3

NEW LIGHT TRUCK RETAIL SALES



Exhib

IMPORT PENETRATION OF NEW LIGHT TRUCK RETAIL SALES

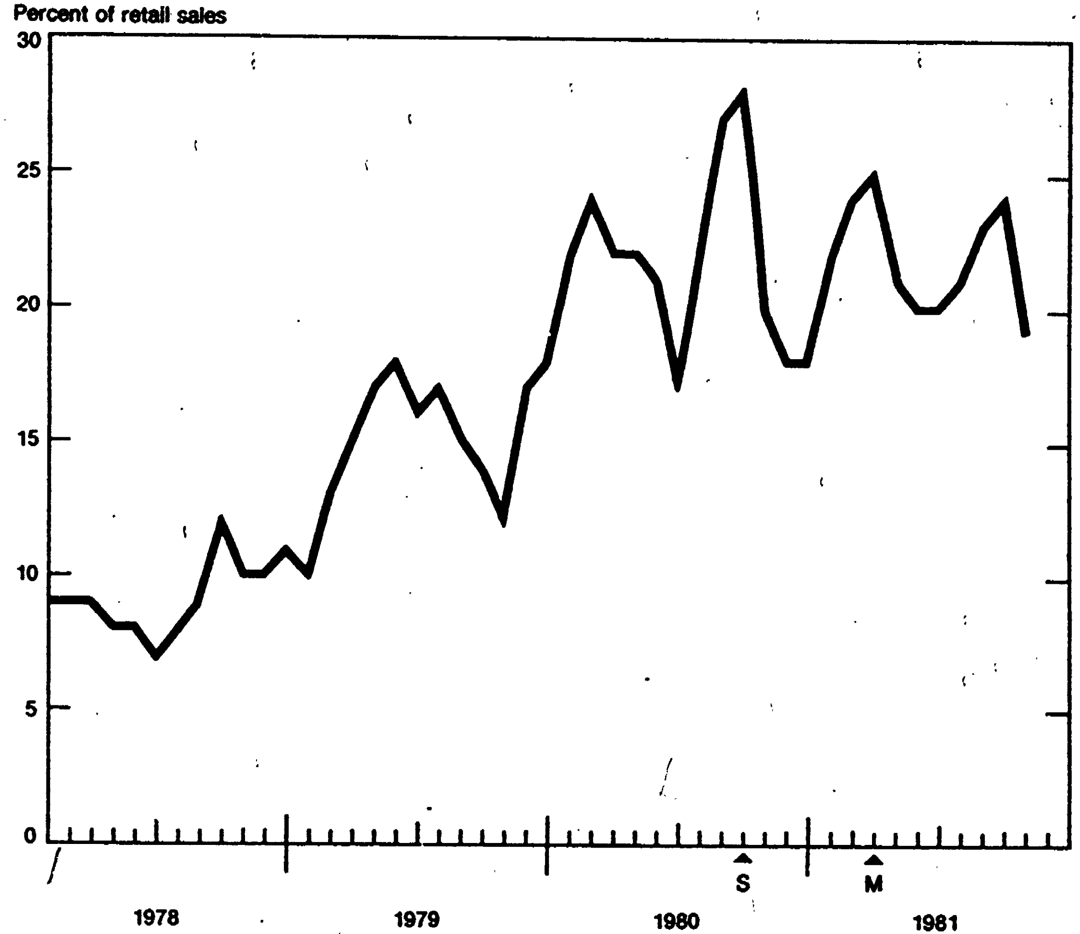
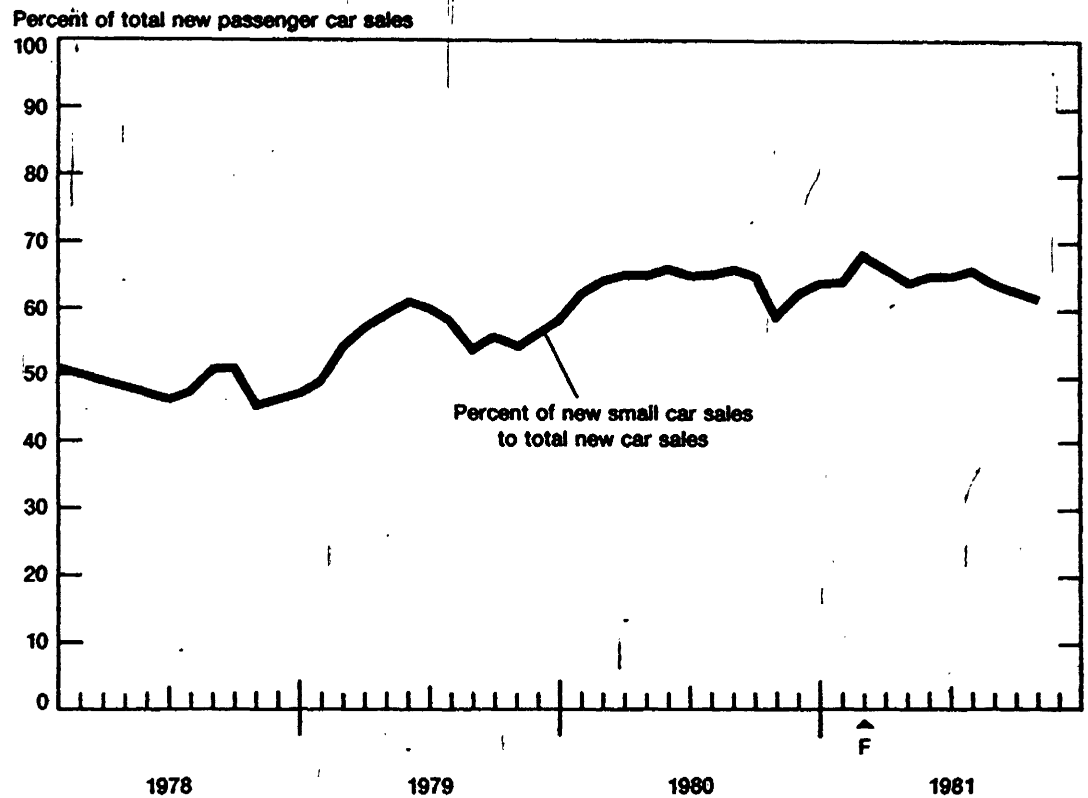


Exhibit 5

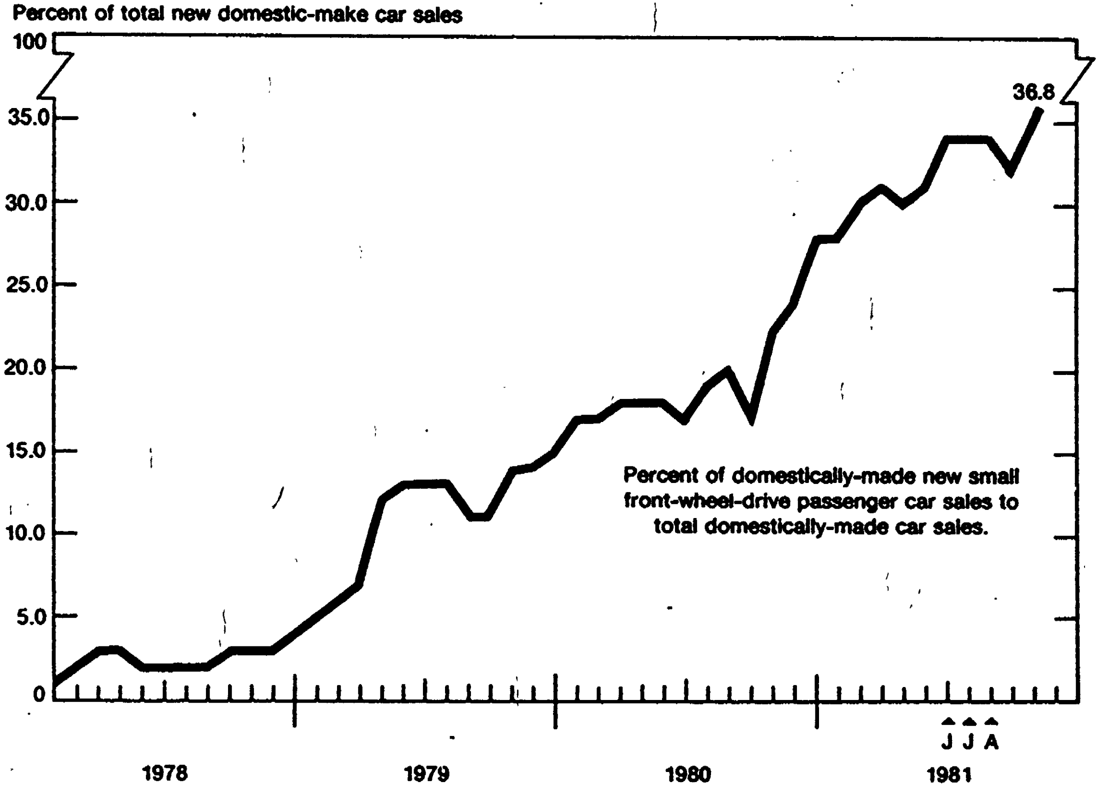
NEW SMALL PASSENGER CAR* SALES
(Including Imports)



*Small passenger cars include subcompacts and compacts.

Exhibit 6

NEW DOMESTIC-MAKE SMALL FRONT-WHEEL-DRIVE PASSENGER CAR* RETAIL SALES



*Small passenger cars include subcompacts and compacts.

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DOMESTIC-MAKE NEW CAR DEALER INVENTORIES

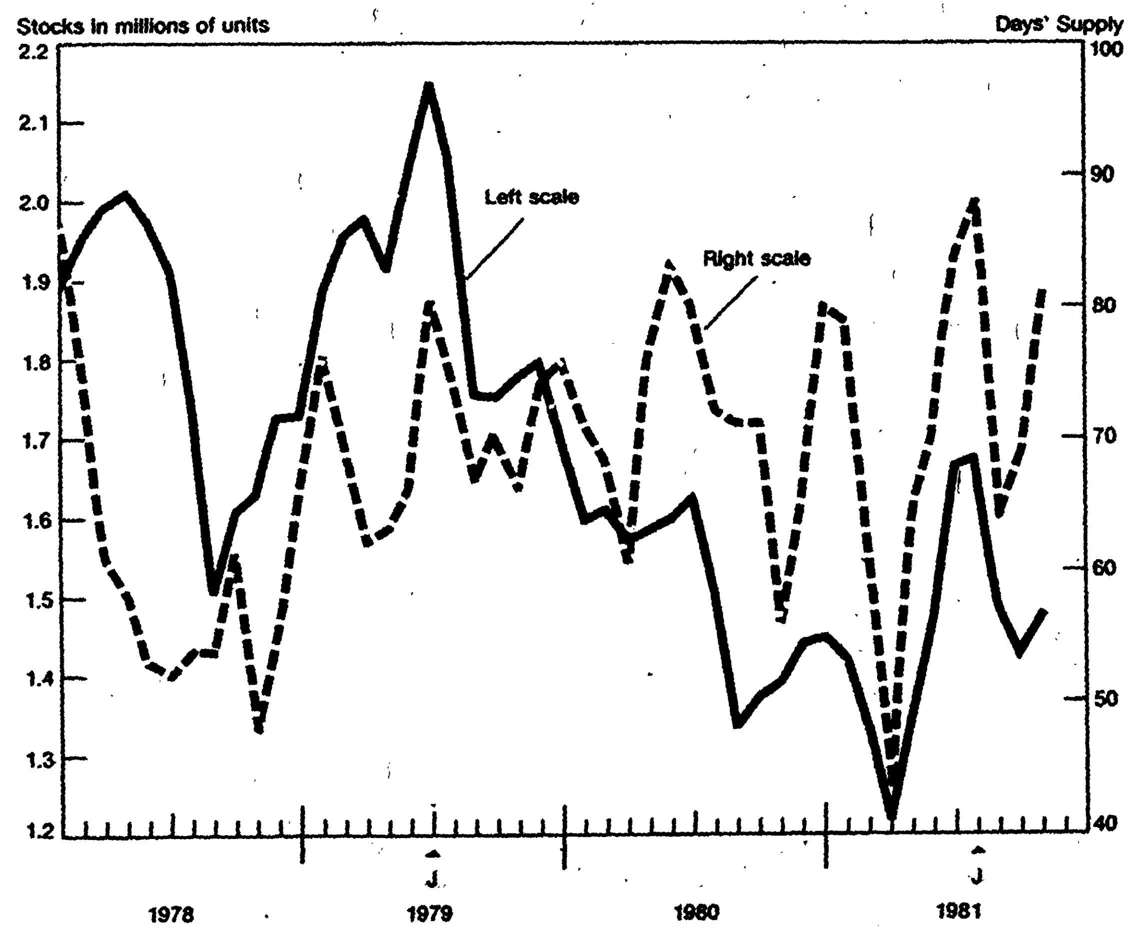
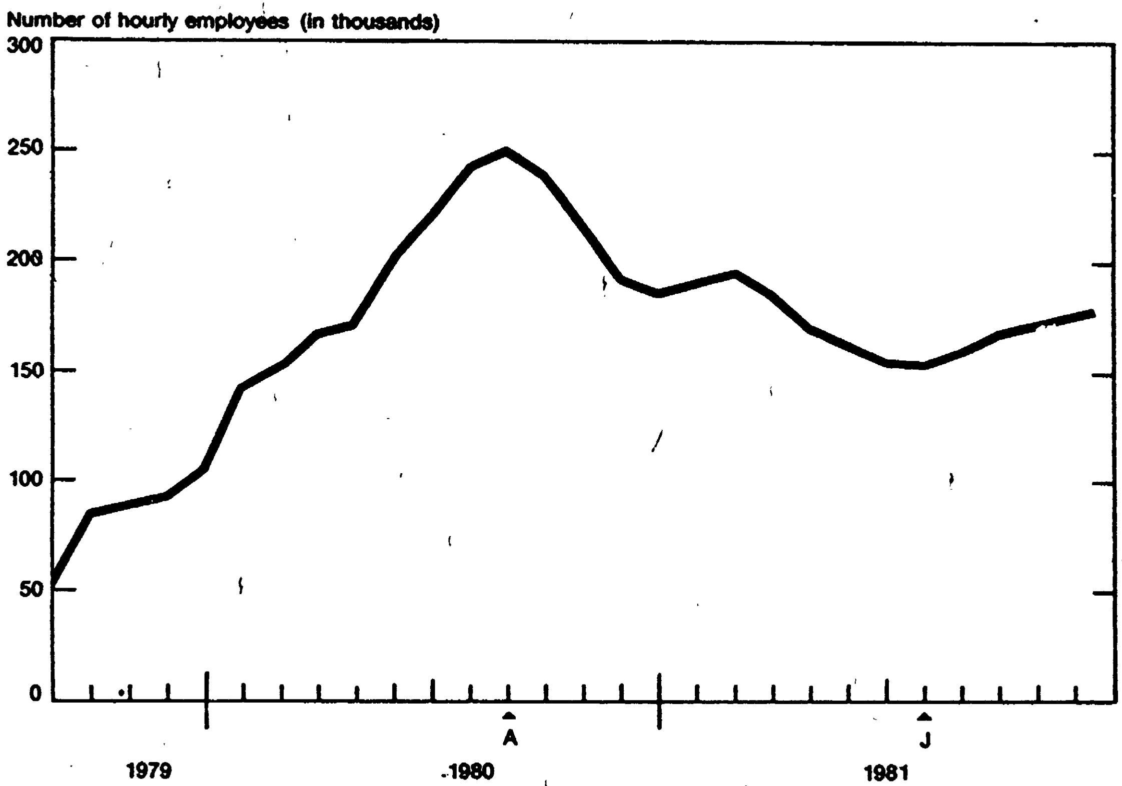


Exhibit 8

INDEFINITE LAYOFFS BY CAR MANUFACTURERS*



*Includes American Motors, Chrysler, Ford, General Motors, and Volkswagen.

Note: Number of indefinite layoffs were insignificant in 1978 and first half of 1979 and were not reported by the car producers.

EXHIBIT 9

TOTAL U.S. EMPLOYMENT

	1978	1979	1980	1st Q	2nd Q (ESTIMATED)	3rd Q (ESTIMATED)	4th Q
GENERAL MOTORS	611,000	619,500	516,750	535,000	550,000	510,000	
FORD	240,250	223,300	164,700	160,600	160,000	150,000	
CHRYSLER	132,300	110,600	79,700	68,000	65,000	65,000	
AMC	25,000	25,000	21,000	21,000	21,000	21,000	
VW	5,000	5,000	6,000	6,000	6,000	6,000	
TOTAL	1,013,550	983,400	788,150	790,600	802,000	752,000	

EXHIBIT 10

MOTOR VEHICLE MANUFACTURING RELATED PLANTS
EMPLOYMENT FOR THE FIVE PRIME MANUFACTURERS*

	Number of Plants		Employment	Employment Change	
	Plants (1978)	Closed Since 1978	1978/79	1981 (Estimated)	Since 1978/79
Michigan	131	12	365,000	280,000	85,000
Ohio	47	2	186,000	140,000	46,000
Indiana	22	3	94,000	70,000	24,000
New York	14	-	65,000	50,000	15,000
Missouri	8	3	30,000	15,000	15,000
Wisconsin	10	-	22,000	18,000	4,000
New Jersey	6	2	20,000	12,000	8,000

*Seven out of 26 auto states represent 90% of employment.

EXHIBIT 11

PERCENT CHANGE IN NEW CAR PRICES
(Seasonally Adjusted)

	Change from Previous Quarter		Change from Same Quarter of Previous Year	
	BLS	BEA	BLS	BEA
Q1 78/77	1.7	1.5	7.2	6.6
Q2	1.5	4.0	7.9	10.5
Q3	2.0	2.2	8.7	10.6
Q4	1.5	2.2	6.8	10.2
Q1 79/78	2.0	2.0	7.3	10.7
Q2	2.7	-0.8	8.5	5.7
Q3	1.8	4.4	8.3	8.0
Q4	0.9	0.1	7.6	5.8
Q1 80/79	2.3	4.8	7.9	8.7
Q2	2.4	1.1	7.6	10.7
Q3	2.6	3.5	8.5	9.7
Q4	0.5	3.4	8.1	13.4
Q1 81/80	-0.2	2.7	5.5	11.0
Q2	3.4	5.7	6.5	16.2
Q3	2.4	4.7	6.2	17.5

EXHIBIT 12

Trend of Domestic vs. Imported New Car Prices
1978 to 1981 by Quarter

		Average domestic car price *	Average imported car price *	Average price for all new cars
1978:	Q1	$ 6,237	$ 5,511	$ 6,096
	Q2	6,452	5,787	6,338
	Q3	6,578	6,007	6,476
	Q4	6,633	6,541	6,617
1979:	Q1	6,790	6,597	6,751
	Q2	6,709	6,670	6,700
	Q3	7,011	6,930	6,995
	Q4	7,084	6,741	7,001
1980:	Q1	7,303	7,445	7,340
	Q2	7,474	7,271	7,418
	Q3	7,741	7,497	7,676
	Q4	8,085	7,549	7,938
1981:	Q1	8,129	8,208	8,150
	Q2	8,501	8,910	8,618
	Q3	8,988	9,125	9,020

* Average new car prices computed by the Bureau of Economic Analysis.

EXHIBIT 13

NEW CAR PAYMENTS AS PERCENT OF
DISPOSABLE PERSONAL INCOME PER HOUSEHOLD

Average Car Loan

	Contract Price	Interest Rate	Loan Duration	Lifetime Interest Expense	Monthly Payment	Payment as % of Disp. Pers. Income*
1978	$5696	13.1%	42.9 Mos.	$1460	$166.81	10.4%
1979	6046	13.5	44.3	1667	174.11	9.8
1980	6476	14.9	44.7	1993	189.47	9.9
1981	7654	16.0	45.1	2576	226.84	10.9

*Average new car monthly payment as a percent of Disposable Personal Income per household.

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EXHIBIT 14

ESTIMATED 1980-81 GLOBAL PRODUCTION CAPACITY, PRODUCTION AND CAPACITY UTILIZATION RATE

	PASSENGER CAR CAPACITY (M)	TRUCK CAPACITY (M)	CAR/TRUCK CAPACITY (M)	TOTAL PRODUCTION (M)	CAPACITY UTILIZATION (%)
NORTH AMERICA	10.0	4.0	14.0	~9.4	70
WESTERN EUROPE	14.0	2.0	16.0	~12.0	75
JAPAN	7.0	4.0	11.0	11.0	100
LATIN AMERICA	1.5	0.5	2.0	1.9	95
OTHER	2.5	2.0	4.5	4.0	90
TOTAL	35.0	13.0	48.0	38.3	80

EXHIBIT 15

YEARLY EXPENDITURES ON PERSONAL TRANSPORTATION
AS A PERCENT OF PERSONAL CONSUMPTION

YEAR	MOTOR VEHICLE AND PARTS	GASOLINE AND OIL	SERVICES	TOTAL
1970	5.8%	3.6%	2.5%	11.9%
1971	6.8	3.6	2.7	13.1
1972	7.1	3.4	2.7	13.2
1973	7.0	3.5	2.5	13.0
1974	5.6	4.1	2.4	12.1
1975	5.7	4.1	2.4	12.2
1976	6.7	4.1	2.5	13.3
1977	7.1	4.0	2.7	13.8
1[illegible]	7.0	3.9	2.7	13.6
1979	6.3	4.5	2.8	13.6
1980	5.5	5.1	2.6	13.2

EXHIBIT 16

Movements in Cost of Operating a Car, January 1978-September 1981

(BLS price indexes seasonally adjusted converted to January 1978 = 100)

	Repairs and Maintenance	Gasoline	Other Personal 1/ Transportation Commodities	Other Personal 2/ Transportation Services	Total Operating, Repair, Finance and Insurance costs 3/
January 1978	100.0	100.0	100.0	100.0	100.0
January 1979	109.1	110.2	106.9	105.1	108.0
January 1980	120.3	176.3	121.6	114.4	142.2
January 1981	133.4	203.1	131.5	127.4	160.9
October 1981	142.1	213.0	137.2	136.7	170.0

1/ Includes motor oil, coolant, tires and other vehicle parts and equipment.

2/ Includes insurance, auto finance charges, vehicle registration, rental fees.

3/ Combines price indexes for component elements with the following December 1977 price relatives: Repairs 1.516; gasoline 4.205; other transportation commodities 0.733; other transportation services 3.416.

Mr. OLMER. Finally, and most importantly, we said that the time for talk is now over. The time for action on the part of the Japan is now.

In my mind, Mr. Chairman, we are running out of time to postpone the hard choices. We cannot accept emergency or limited, piecemeal concessions. We need a measurable and sustained increase in Japanese imports of U.S. manufactured goods, including autos and auto parts. Although Japan is the second largest economy in the free world, its imports of manufactures are about equivalent to those of Switzerland. Japan's imports of manufactures on a per capita basis are the lowest in the industrial world.

We need a dismantling of the web of blatantly protective devices that surround Japanese agriculture. We need a reduction in some of Japan's remaining high duties on manufactured goods.

We need elimination of the permissive treatment of business cartels in Japan and the informal industry clubs which restrict imports and sustain uncompetitive Japanese industries. Such devices keep out competitive U.S. exports even though the U.S. export price is substantially lower than domestic prices in Japan.

And finally, we need an opening up of Japanese high technology development programs to genuine market competition, including the participation of foreign firms.

The United States-Japan economic relationship—the single most important economic relationship in the free world—is clearly in serious trouble. The problem has been developing for well over a decade. With a $20 billion deficit looming for next year, 1982, I think we are running out of time for discussion.

Our economic relationship has not been conducted on a fully reciprocal basis, and I believe it should be. Our trading relationship must afford us substantially equivalent competitive opportunity, nothing less; and I do not think we need anything more.

The time for a genuine and effective Japanese response is now.

Thank you, Senator.

Senator DANFORTH. Thank you, Mr. Olmer. Your comments have been by far the most realistic of any administration representative that I have heard since I have been the chairman of this subcommittee.

Mr. Hormats.

STATEMENT OF HON. ROBERT D. HORMATS, ASSISTANT SECRETARY OF STATE FOR ECONOMIC AND BUSINESS AFFAIRS

Mr. HORMATS. Thank you, Mr. Chairman.

I would just like to make a few general remarks and then speak specifically to the subject of parts and the attempt to increase U.S. parts sales to Japan and to the United States aftermarket, which I have been asked to talk about.

First let me make a couple of general observations about the overall nature of the United States-Japanese trading relationship. I would just like to second what Ambassador Macdonald and Undersecretary Olmer have said about this relationship. There is no question today—and I think you and Senator Dole indicated that at the outset—but that the overall imbalance between the United States and Japan is growing and is becoming more and more of an economic and, indeed, a political and a security irritant. The problem with this imbalance is that it highlights also the imbalance in openness between the U.S. market and the Japanese market.

There is no sector today that I can point to in which Japanese exports to the United States are restricted in the same way or to the same degree that United States exports to Japan are restricted. One needs only to look at citrus and meat and auto parts and a whole host of other products to see that it is very difficult in certain sectors to get into the Japanese market, and then, in certain sectors where tariffs are lowered, there are a whole host of social or, as was indicated earlier, personal barriers; people simply prefer to buy Japanese and have developed traditional supply-demand relationships with Japanese suppliers. As a result of that, Americans, even though they are trying hard to get into the Japanese market, are finding it very difficult to do so.

The notion was originally put out that somehow Americans were not investing the time or the effort, didn't know the language, and therefore were not able to get into the Japanese market. That is simply not true, and it is not true because all you have to do to disprove that theory is talk to all the other countries who try to sell to Japan. They encounter the same problems: The Australians; the Koreans, many of whom have a very traditional relationship with Japan and speak Japanese; and the Europeans. Virtually everyone who tries to get into the Japanese market finds the same problems. So it is not a problem that is peculiarly endemic to the United States, and it is certainly not one that I think results from lack of interest or enthusiasm on the part of American suppliers.

I think the last point I would make of this general nature is that the Japanese have a peculiar habit of protecting, one way or another, a particular sector using an infant industry argument. They protect it long beyond the infancy of the industry and then they argue for free trade in that sector. This is the difficulty we encountered in the auto sector earlier on in the 1950's and 1960's, and it is the difficulty we confront today in the high technology industries. We simply find it very difficult to get into these new sectors. The Japanese build up very substantial economies of scale. Once they have done that they can do all sorts of forward pricing on the international market, and as a result, unless we crack the Japanese home market at an early stage and get our products in, the Japanese can build up behind these protective walls very, very competitive industries with huge economies of scale which enables them very effectively to compete internationally.

So while we deal with auto parts and autos and other things today, we may well be facing over the next several years, the same phenomenon occurring in the high technology area, and that could, if we do not get on top of it early enough, damage our competitiveness in the new industries of the 1980's and 1990's and the year 2000.

Let me just make a few general points without going into detail on my testimony on the question of auto parts. I have a strong interest in this subject both because the auto parts section is an important part of the U.S. auto industry as a whole and because, while serving as Deputy Trade Representative a couple of years ago, I spent a good deal of time and effort encouraging the Japanese to make a greater effort in this area.

The difficulties in this industry are illustrated by the fact that employment among the approximately 2,000 firms in this sector has dropped by as much as 500,000 since January 1979. This places this part of the industry along with the overall industry in the midst of a major downturn.

First, in order to deal with this problem we have sought greater access for U.S.-made parts to the Japanese market and to the so-called after market for replacement parts for Japanese cars sold in the United States.

Second, we have favored economically viable Japanese-United States joint ventures or Japanese licensing agreements with U.S. parts producers. The Japanese have, after a number of discussions and negotiations we had with them a couple of years ago, obtained Diet approval for the elimination of tariffs on 38 automotive parts categories and for a substantial reduction of the tariff on tires and tire cases. These were put into effect on April 1, 1981. There were several items that we were not able to get as much progress on as we wanted in this category. Our own data indicated that U.S. exports in these products were about $100 million in 1980.

In addition, however, to getting just reductions and eliminations of tariffs, there was a cosponsored mission by Japan and the United States, a mission of Japanese producers with the objective of increasing their purchases of U.S.-made auto parts. This took place in September 1980. The results of this are being monitored by the Department of Commerce, the Trade Facilitation Committee and MITI. The estimate was that the exports of those parts would go up from about $100 million in 1980 to about $300 million in 1981. This was a forecast which was again reaffirmed in the early part of this year, in January. The problem, however, is that the results that were expected and indeed projected have simply not occurred; for the first 6 months of this year, the figures totaled only $64 million, which means that it is going to fall far short of the $300 million forecast. Even this total depends on the inclusion of chemical catalysts and cattle leather, some of which is probably not even going to be used for automotive uses.

We have also found that the firms that the Department of Commerce has polled have indicated that only 12 percent of them felt that the mission had been very productive, and many of them are increasingly disappointed with the results of those missions.

Now, there are a number of contracts that are under negotiation today, but to date we have only been able to identify about $5.5 million in actual new business. Contrast this to the projection or the fact that a Japanese bank has indicated that total Japanese auto parts exports in 1980 were $3.8 billion, and about $1.8 billion of these were to the United States, so that in addition to the overall auto imbalance that we are talking about, there is an imbalance in parts as well.

I will not go into detail on the difficulties of getting into the Japanese parts market. There are traditional relationships between suppliers and producers of parts in the so-called supplier family. There are also problems of delivery. The Japanese parts makers have their parts delivered sometimes two and three times a day to a Japanese factory, and it is very difficult for American firms to provide parts on that sort of time schedule with that degree of frequency.

So it is hard to get into that market for structural reasons. It is also hard because I think it is fair to say that the Japanese firms have not really gone out of their way to help American firms to export as we had anticipated they would as a result of that mission.

The efforts of the Japanese Government and the Japanese private sector to boost imports of U.S.-made parts have not been satisfactory. It appears that Japanese automotive industry officials may have come to believe that Japan's unilateral voluntary restraint on automobiles has relieved the Japanese industry of any need to pursue seriously opportunities to buy auto parts here.

If this is the case, it would be extremely unfortunate. We had hoped and indeed been led to believe that the Japanese auto industry was genuinely desirous of helping U.S. industry to make it through its present crisis. It is disappointing that progress has not been made in this area.

The after-market element of the overall scene is particularly important, because it is our judgment that the aftermarket for U.S. made replacement parts for Japanese cars here in the United States might amount to something on the order of $1.8 billion over the next 5 years. This market is one in which U.S. firms should—if given a chance—be able to compete actively and successfully.

But it has been very hard for American firms to penetrate this market, and Japanese firms appear reluctant to fully cooperate with them, while Japanese parts, as the figures indicate, sell quite vigorously. In our judgment, the same argument which is applied by the Japanese to explain why it is so difficult to penetrate that Japanese parts market, do not apply to the U.S. after-parts market here. There is no reason why the Japanese firms who do buy those parts cannot make it easier for American firms to sell in that after market.

Japan, which professes to support an open trading system, undermines its credibility by failing to take advantage of opportunities to permit and actively to help U.S.-made parts to compete in both the original equipment and the replacement parts market.

With respect to investment, the results have been similarly quite disappointing, as your statement indicates, Mr. Chairman, and we have really not seen the sort of licensing or joint production arrangements between Japanese and American firms that we had hoped and which American parts firms were indeed looking forward to.

I would just conclude on a relatively pessimistic note. We have been urging for the last couple of years—and I think this is something that the last administration and this administration feel very strongly about and have been pressing, so there is no inconsistency in approach here—we have been pressing very hard for the Japanese to open up in this area, and we have found progress very slow, very frustrating, and very disappointing. It strikes me that if we are to conclude that Japan believes that the actions it has already taken represent a final and adequate response on its part, I think we can only expect that things are not going to improve very much in this area.

If the Japanese do more in the parts area it can help improve their credibility as a country which is genuinely interested in increasing and expanding trade. The restrictions that they have imposed, the difficulty in getting into this market undermine the Japanese credibility and hurts our industry.

We perhaps have one ray of hope in this whole thing, and that is that Japan's new Foreign Minister and MITI Minister have both stressed the need for a broader opening of Japan's market. The above-mentioned measures in the original parts market and the after-parts market, joint production and licensing, in conjunction with others in the area of agriculture and manufactured goods, would be an excellent beginning for the new ministers in Japan. Ambassador Macdonald will be heading up a group to go to Japan, and it is our hope that the new ministers in Japan can really make a major effort in this area.

[The prepared statement of Secretary Hormats follows:]

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STATEMENT OF ROBERT D. HORMATS
ASSISTANT SECRETARY OF STATE FOR
ECONOMIC AND BUSINESS AFFAIRS
BEFORE THE SUBCOMMITTEE ON
INTERNATIONAL TRADE
OF THE COMMITTEE ON FINANCE
UNITED STATES SENATE
WASHINGTON, D.C.
DECEMBER 1, 1981

MR. CHAIRMAN:

I WOULD LIKE TO THANK THE SUBCOMMITTEE FOR INVITING ME TO TAKE PART IN ITS REVIEW OF THE CURRENT STATE OF THE U.S. AUTO INDUSTRY AND RELATED ISSUES IN THE AREA OF INTERNATIONAL TRADE AND INVESTMENT. I WOULD LIKE TO CONCENTRATE MY REMARKS ON A SUBJECT OF MAJOR INTEREST TO THE U.S. AUTO INDUSTRY AND TO ME PERSONALLY -- RECENT DEVELOPMENTS AFFECTING OUR AUTO PARTS MANUFACTURERS. I HAVE A PARTICULAR INTEREST IN THIS BECAUSE I WAS DIRECTLY INVOLVED IN EARLIER EFFORTS TO ASSIST OUR AUTO PARTS COMPANIES WHILE SERVING AS DEPUTY TRADE REPRESENTATIVE. I UNDERSTAND THAT THE SUBCOMMITTEE WISHES ME TO COMMENT ON THE RESULTS ACHIEVED TO DATE FROM THE PERSPECTIVE OF THAT EXPERIENCE.

THE AUTOMOTIVE PARTS AND COMPONENTS SECTOR IS SUFFERING FROM THE DEPRESSION WHICH HAS HIT THE AUTOMOBILE INDUSTRY AS A WHOLE. EMPLOYMENT AMONG THE APPROXIMATELY 2,000 FIRMS IN THIS SECTOR HAS DROPPED BY AS MUCH AS 500,000 SINCE JANUARY 1979. SALES HAVE BEEN SOFT FOR THE LAST YEAR AND A HALF AND MOST PARTS FIRMS ARE NOW OPERATING BELOW CAPACITY, WHICH IS UNUSUAL IN THIS SECTOR. THE AUTO PARTS COMPANIES CONSEQUENTLY FACE A FAMILIAR FINANCIAL DILEMMA. THEY WANT TO INVEST SUBSTANTIAL CAPITAL IN EFFICIENT, LOW-COST PRODUCTION FACILITIES IN ORDER TO MEET INCREASINGLY EFFECTIVE FOREIGN COMPETITION. REDUCED SALES AND HIGH INTEREST RATES, HOWEVER, MAKE THAT INVESTMENT EXCEPTIONALLY DIFFICULT TO UNDERTAKE, AND JERRY DEMPSEY, PRESIDENT OF BORG-WARNER, HAS WARNED THAT AS MANY AS TWO-THIRDS OF THE EXISTING PARTS COMPANIES MAY BE GONE BY THE NEXT DECADE.

IN ORDER TO HELP THE AUTO PARTS INDUSTRY COPE WITH THESE PRESSURES, TWO TRADE POLICY OBJECTIVES OF MAJOR IMPORTANCE HAVE BEEN PURSUED BY THE UNITED STATES OVER THE PAST FEW YEARS. FIRST, WE HAVE SOUGHT GREATER ACCESS FOR U.S.-MADE PARTS TO THE JAPANESE MARKET AND TO THE SO-CALLED "AFTER-MARKET" FOR REPLACEMENT PARTS FOR JAPANESE CARS SOLD IN THE U.S. SECOND, WE HAVE FAVORED ECONOMICALLY VIABLE JAPANESE-U.S. JOINT VENTURES OR JAPANESE LICENSING AGREEMENTS WITH U.S. PARTS PRODUCERS.

EFFORTS TO INCREASE PARTS SALES

EFFORTS BY THE U.S. TO INCREASE SALES OF AUTO PARTS TO BE USED IN JAPANESE-BUILT CARS AND AS REPLACEMENT PARTS FOR JAPANESE CARS IN THE UNITED STATES DATE BACK ALMOST TWO YEARS. IN APRIL 1980, THE U.S. ASKED THE GOVERNMENT OF JAPAN TO ELIMINATE IMPORT DUTIES ALTOGETHER ON ALL AUTOMOBILE PARTS, INCLUDING ORIGINAL EQUIPMENT COMPONENTS AND REPLACEMENT PARTS. AFTER EXTENSIVE NEGOTIATIONS, THE JAPANESE OBTAINED DIET APPROVAL FOR THE ELIMINATION OF TARIFFS ON 38 AUTOMOTIVE PARTS CATEGORIES, AND FOR A SUBSTANTIAL REDUCTION OF THE TARIFF ON TIRES AND TIRE CASES. THESE REDUCTIONS, WHICH WENT INTO EFFECT ON APRIL 1, 1981 -- WERE ON ITEMS THE U.S. GOVERNMENT, IN CONSULTATION WITH THE U.S. INDUSTRY, HAD IDENTIFIED AS OF GREATEST INTEREST TO OUR FIRMS. OUR OWN EXPORT DATA INDICATE THAT U.S. EXPORTS OF THESE PRODUCTS TO JAPAN AMOUNTED TO ABOUT $100 MILLION IN 1980. WE WERE UNSUCCESSFUL IN PERSUADING THE JAPANESE TO ABOLISH DUTIES ON CARPETING; THE JAPANESE ARGUED THAT CARPETING IS A PRODUCT CATEGORY DESTINED LARGELY FOR NON-AUTOMOTIVE CONSUMPTION.

IN ADDITION TO SEEKING TARIFF REDUCTIONS, WE AND THE JAPANESE GOVERNMENT SPONSORED AN AUTO PARTS-PURCHASING MISSION, WHICH MET WITH U.S. AUTOMOTIVE PARTS FIRMS IN SEPTEMBER 1980 TO EXPLORE THE POSSIBILITIES OF NEGOTIATING CONTRACTS FOR AUTO PARTS. THE RESULTS OF THIS AUTO PARTS MISSION ARE BEING BE MONITORED BY THE TRADE FACILITATION COMMITTEE, CHAIRED BY THE DEPARTMENT OF COMMERCE AND THE MINISTRY OF INTERNATIONAL TRADE AND INDUSTRY (MITI).

THE JAPANESE FORECAST LAST YEAR, IN CONJUNCTION WITH THE AUTO PARTS MISSION, THAT THEIR IMPORTS OF U.S. AUTO PARTS WOULD RISE TO SOME $300 MILLION IN 1981. THEY REAFFIRMED THIS FORECAST AFTER A TFC FOLLOW-UP MEETING LAST JANUARY.

ON BALANCE, HOWEVER, THE RESULTS OF THIS EFFORT IN TERMS OF AUTO PARTS EXPORTS HAVE BEEN EXTREMELY DISAPPOINTING. IT IS CLEAR THAT THE $300 MILLION FORECAST WILL NOT BE REALISED, AND THAT OUR PARTS EXPORTS TO JAPAN WILL PROBABLY DECREASE IN COMPARISON WITH LAST YEAR. OFFICIAL DATA PREPARED BY THE JAPANESE AUTHORITIES INDICATE THAT THEIR IMPORTS OF THE PRODUCTS COVERED BY THE $300 MILLION FORECAST TOTALLED ONLY $64 MILLION DURING THE FIRST SIX MONTHS OF THIS YEAR. EVEN THIS TOTAL DEPENDS ON THE INCLUSION OF CHEMICAL CATALYSTS AND CATTLE LEATHER, OF WHICH A SUBSTANTIAL PORTION PROBABLY ARE DESTINED FOR NON-AUTOMOTIVE USES. SIMILARLY, THE LATEST COMMERCE SURVEY OF THE U.S. AUTO PARTS FIRMS INVOLVED IN THE PARTS MISSION INDICATES THAT THE MISSION HAS NOT GENERATED A STEADY STREAM OF NEW ORDERS. EIGHTY PERCENT OF THE FIRMS RESPONDED TO THE SURVEY THIS YEAR AND ONLY 12 PERCENT OF THEM FELT THAT THE MISSION HAD BEEN VERY PRODUCTIVE. WE HAVE BEEN ABLE TO IDENTIFY ONLY $5.5 MILLION IN ACTUAL NEW BUSINESS. THIS CONTRASTS STARKLY WITH A RECENT REPORT BY THE MITSUBISHI BANK THAT TOTAL JAPANESE AUTO PARTS EXPORTS REACHED $3.8 BILLION IN 1980, UP NEARLY 30 PERCENT FROM 1979, OF WHICH ABOUT $1.8 BILLION WERE TO THE U.S.

IN ORDER TO UNDERSTAND THE DIFFICULTY OF PENETRATING THE JAPANESE PARTS MARKET, IT IS USEFUL TO UNDERSTAND CERTAIN BASIC STRUCTURAL PROBLEMS. THESE INCLUDE THE HIGH COST OF TRANSPORTATION TO JAPAN, THE STRICT -- AND SOMETIMES OVERLY STRICT -- QUALITY STANDARDS DEMANDED BY THE JAPANESE AUTOMAKERS, AND THE BASIC MANAGEMENT RELATIONSHIP BETWEEN JAPANESE AUTOMOBILE PRODUCERS AND THEIR "FAMILY" OF PARTS SUPPLIERS. MOST JAPANESE AUTO PLANTS MAINTAIN MINIMAL ON-SITE PARTS INVENTORIES, AND SUPPLIERS ARE EXPECTED TO MAKE DELIVERIES ON TIGHT SCHEDULES, OFTEN SEVERAL TIMES A DAY. TARIFF ELIMINATIONS ALONE, AS I HAVE TESTIFIED IN THE PAST, CANNOT OFFSET SUCH FUNDAMENTAL PROBLEMS IN EXPANDING ACCESS TO THE JAPANESE HOME MARKET. AN ACTIVE EFFORT BY THE JAPANESE GOVERNMENT AND THE JAPANESE COMPANIES -- AS WELL AS BY U.S. PARTS MANUFACTURERS -- IS NECESSARY.

IT IS FAIR TO SAY THAT THE EFFORTS OF THE JAPANESE GOVERNMENT AND THE JAPANESE PRIVATE SECTOR TO BOOST IMPORTS OF U.S.-MADE PARTS HAVE NOT BEEN SATISFACTORY. THE SURVEYS OF U.S. AUTO PARTS FIRMS SUGGEST THAT MANY JAPANESE FIRMS INVOLVED IN LAST YEAR'S PARTS MISSION MAY HAVE BEEN MORE INTERESTED IN EXPANDING THEIR SALES HERE THAN FINDING NEW U.S. SUPPLIERS.

IT APPEARS THAT JAPANESE AUTOMOTIVE INDUSTRY OFFICIALS MAY HAVE COME TO BELIEVE THAT THE JAPAN'S UNILATERAL VOLUNTARY RESTRAINT ON AUTOMOBILES HAS RELIEVED THE JAPANESE INDUSTRY OF ANY NEED TO PURSUE SERIOUSLY OPPORTUNITIES TO

BUY AUTO PARTS HERE. IT WOULD BE EXTREMELY UNFORTUNATE IF THEY PERSISTED IN THIS VIEW. WE HAVE BEEN LED TO BELIEVE THAT THE JAPANESE AUTO INDUSTRY WAS GENUINELY DESIROUS OF HELPING U.S. INDUSTRY TO MAKE IT THROUGH ITS PRESENT CRISIS. THE JAPANESE EXPORT RESTRAINT -- LIMITED AS IT IS -- CANNOT COMPRISE THE WHOLE EFFORT TO DEAL WITH THE TRADE-RELATED ASPECTS OF THAT CRISIS. AS I TESTIFIED BEFORE THIS SUB-COMMITTEE LAST JANUARY, SUBSTANTIAL INCREASES IN JAPANESE PURCHASES OF U.S. PARTS WOULD BE BOTH REASONABLE AND AP-PROPRIATE. THE ADMINISTRATION WILL CONTINUE TO URGE THE JAPANESE TO ACCEPT,AND TO ACT ON THE BASIS OF, THIS POINT -- PARTICULARLY IN THE MEETINGS OF THE TRADE FACILITATION COMMITTEE WHICH WILL TAKE PLACE IN TOKYO LATER THIS MONTH.

IN VIEW OF THE INHERENT MARKETING DIFFICULTIES FACING FIRMS TRYING TO EXPORT PARTS TO JAPAN, THE "AFTERMARKET" FOR U.S.-MADE REPLACEMENT PARTS FOR JAPANESE CARS HERE IN THE U.S. MAY BE MORE IMPORTANT IN THE NEAR TERM FOR THE U.S. PARTS COMPANIES. IT HAS BEEN ESTIMATED THAT THE MARKET FOR SUCH ITEMS AS BATTERIES, LIGHTS, FAN BELTS, TIRES, STARTERS, AS SO ON, COULD AMOUNT TO $1.8 BILLION OVER THE NEXT FIVE YEARS. THIS MARKET IS ONE IN WHICH U.S. FIRMS SHOULD BE ABLE TO COMPETE ACTIVELY AND SUCCESSFULLY. BUT IT HAS BEEN VERY HARD FOR AMERICAN FIRMS TO PENETRATE THIS MARKET, AND JAPANESE FIRMS APPEAR RELUCTANT TO FULLY COOPERATE WITH THEM, WHILE JAPANESE PARTS SELL VIGOROUSLY. THE SAME

STRUCTURAL ARGUMENT TO WHICH JAPAN POINTS TO EXPLAIN WHY U.S. PARTS DO NOT SELL WELL IN JAPAN DOES NOT APPLY TO THE REPLACEMENT MARKET.

BECAUSE THE "AFTERMARKET" LOOKS LIKE SUCH A PROMISING AREA FOR ADDITIONAL U.S. PARTS SALES, IT SHOULD BE GIVEN PRIORITY ATTENTION BY JAPANESE FIRMS AND BY THE TFC. OPENING UP THIS MARKET TO U.S. FIRMS CAN BE HIGHLY BENEFICIAL AND IT WILL HELP TO OFFSET THE ATTRACTION OF MORE RESTRICTIVE AND DISTORTIVE APPROACHES TO THE AUTOMOTIVE INDUSTRY'S TROUBLES. JAPAN, WHICH PROFESSES TO SUPPORT AN OPEN TRADING SYSTEM, UNDERMINES ITS CREDIBILITY BY FAILING TO TAKE ADVANTAGE OF OPPORTUNITIES TO PERMIT AND ACTIVELY TO HELP U.S.-MADE PARTS TO COMPETE IN BOTH THE ORIGINAL EQUIPMENT AND REPLACEMENT PART MARKETS.

INVESTMENT

WE HAD ALSO HOPED THAT JAPANESE PARTS FIRMS WOULD CONSIDER VIABLE JOINT VENTURES AND LICENSING FOR PARTS PRODUCTION HERE IN THE U.S. THE JAPANESE GOVERNMENT SPONSORED A SECOND MISSION LAST YEAR FOR JAPANESE FIRMS INTERESTED IN SUCH POSSIBILITIES. THE MAJOR OBJECTIVE OF THAT MISSION WAS TO ENCOURAGE JOINT PRODUCTION VENTURES OR LICENSING OF PARTS PRODUCTION, TO PERMIT OUR OWN COMPANIES TO PREPARE MORE RAPIDLY TO PRODUCE PARTS FOR THE NEW GENERATION OF "WORLD CARS" COMING ONTO THE MARKET. TO DATE, HOWEVER, THE INVESTMENT MISSION HAS PRODUCED NO CONCRETE RESULTS IN TERMS OF NEW

JOINT VENTURES OR LICENSING INVOLVING U.S. FIRMS. MY OWN VIEW IS THAT LICENSING REMAINS A PARTICULARLY PROMISING APPROACH TO ENSURING U.S. FIRMS' ACCESS TO THE AFTERMARKET, AND IS ONE WHICH SHOULD BE PURSUED VIGOROUSLY IN OUR DISCUSSIONS WITH THE JAPANESE IN THE TFC AND ELSEWHERE.

THE ONLY NEW INVESTMENT PROJECTS WE HAVE IDENTIFIED ARE THE OPENING OF A NEW PLANT IN OHIO BY STANLEY ELECTRIC OF JAPAN TO SUPPLY ELECTRICAL PARTS TO HONDA'S NEW AUTO ASSEMBLY PLANT AND OTHER AUTOMAKERS, AND A JOINT VENTURE BY HONDA AND TWO JAPANESE PARTS FIRMS TO BUILD SEATS AND MUFFLERS FOR THE HONDA PLANT. THE LATTER PROJECT WILL EMPLOY SOME 200 WORKERS. BOTH THE HONDA AUTO PLANT AND NISSAN'S TRUCK PLANT IN TENNESSEE ARE EXPECTED TO PROCURE INITIALLY ABOUT 40 PERCENT OF THEIR INPUTS, BY VALUE, FROM U.S. SUPPLIERS, WITH THE POSSIBILITY OF FUTURE INCREASES IN SUCH PROCUREMENT.

CONCLUSION

FOR THE LAST TWO YEARS I HAVE BEEN URGING THAT JAPAN, IN ITS OWN LONG-TERM INTEREST AND IN OURS, BUY MORE U.S. PARTS, AND UNDERTAKE ECONOMIC CO-PRODUCTION AND LICENSING ARRANGEMENTS WITH U.S. FIRMS. ARE WE TO CONCLUDE THAT JAPAN BELIEVES THAT THE SHORT-TERM ACTIONS THEY HAVE TAKEN ON AUTO EXPORTS REPRESENT A FINAL AND ADEQUATE RESPONSE ON ITS PART, AND THAT THE MUTUALLY BENEFICIAL AND EXTREMELY REASONABLE

OBJECTIVES OF INCREASING U.S. PARTS SALES TO JAPAN AND TO THE REPLACEMENT MARKET, AND OF PROMOTING JOINT VENTURES AND LICENSING AGREEMENTS, CAN NOW BE VIRTUALLY NEGLECTED? IF SO, THAT IS EXTREMELY SHORT-SIGHTED. IF THE JAPANESE WANT TO PROVIDE CONVINCING EVIDENCE THAT MUTUALLY BENEFICIAL TRADE IN THIS SECTOR IS POSSIBLE, THEY HAVE A STRONG INTEREST IN PROVIDING OPPORTUNITIES FOR U.S. PARTS PRODUCERS TO COMPETE IN JAPAN AND IN THE REPLACEMENT MARKET -- AND ASSIST RATHER THAN IMPEDE THEIR EFFORTS TO DO SO -- AND TO UNDERTAKE ECONOMICALLY ATTRACTIVE LICENSING AND CO-PRODUCTION HERE. JAPAN'S NEW FOREIGN MINISTER AND MITI MINISTER HAVE BOTH STRESSED THE NEED FOR A BROADER OPENING OF JAPAN'S MARKET. THE ABOVE-MENTIONED MEASURES -- IN CONJUNCTION WITH OTHERS IN THE AGRICULTURAL AND MANUFACTURED GOODS SECTORS -- WOULD BE AN EXCELLENT BEGINNING.

Senator DANFORTH. Gentlemen, thank you very much.

You will remember that last winter I introduced a bill which would have restricted the imports of Japanese automobiles, stating at the time that I did so reluctantly, that I had always considered myself to be a free trader, not a protectionist, but that I was not willing to just stand by and see a major American industry go down the drain—particularly when we do not really have a relationship based on free trade with Japan. It is a myth, as Mr. Olmer in particular has pointed out.

I did not press that bill when the Japanese agreed to restrict their exports to this country, but I stated at the time that I wanted to see how the management would work out in practice.

It would appear from the testimony today that overall it really has not worked out very well: the agreement itself has been complied with but the parts arrangement has not worked out; the total trade imbalance with Japan has gotten worse, not better; and our auto industry continues to be in a very bad slump.

Now, under the arrangement that the Japanese entered into in the spring, a base figure that was established for 1981 of 1.68 million units. Them for the second year, for 1982, that base figure was to be adjusted by plus or minus 16.5 percent of the increase or decreases in the projected figure for total car sales in the United States, is that right?

Ambassador MACDONALD. That is correct.

Senator DANFORTH. Obviously, what is projected for the second year is the key to determining how the arrangement is going to work out in practice for 1982.

Similarly, another open question is what is going to happen in the third year. One thing that I stated at the time that the Japanese announced their arrangement was that I doubted that 2 years would be enough.

Well, now it appears clear that because of the worse performance of the automobile industry in general, 2 years is not going to be sufficient.

Are there ongoing conversations, Ambassador Macdonald, between the U.S. Trade Representative and the Japanese with respect to the projections for the 1982 restraint year, and have there been discussions with the Japanese, or will there be discussions with the Japanese with respect to the necessity of extending the arrangement beyond the 3-year period?

Ambassador MACDONALD. Mr. Chairman, there have not been ongoing discussions with the Japanese regarding projections for Japanese year 1982. That year is about 4 months away from commencing now. I would expect that those discussions would start perhaps in about 1 month when things begin to clarify.

The third year, as Ambassador Brock announced it at the time of the issuance of the restraint promulgated, was designed to be an antisurge year, in other words, that both sides would monitor the Japanese exports with a view to keeping them from surging so that there could be confidence in the U.S. auto industry and to its lenders that the kind of capital that had to be made available to the auto industry would indeed be a risk that its lenders would be willing to take.

Senator DANFORTH. Senator Dole?

Chairman DOLE. Thank you.

First of all, I think everyone on the panel has indicated a rather firm attitude toward a very serious problem, and I would make one additional observation. Somebody said it is becoming a political problem. I think you can take out the "becoming." It is a political problem now; it is not becoming a political problem. It is one that this committee views very seriously, and I would hope, Ambassador Macdonald, that when you travel to Japan next week, December 9 and 10, that you can indicate that this committee feels very strongly. In fact, I was informed by Senator Danforth that he may, prior to your departure, present you with a resolution passed by the Senate Finance Committee to indicate our concern.

So we agree with the views expressed by every member of this panel that we cannot tolerate as a committee or the Congress or an administration or a country ever-increasing trade deficits of, anticipated to be what, $50 billion by the year 1990? That will not happen. We just cannot permit that to happen, and I would hope that there are measures being considered. I am certain there are.

I understand that you will make very specific requests in your meetings on the 9th and 10th, is that correct?

Ambassador MACDONALD. Well, that is correct. We do have a number of very specific problems, but there is an endemic underlying problem which will be, I think, valuably articulated if such a resolution were forthcoming, and that is that our trading system does depend upon a certain set of rules, and one of those rules is that price, quality and performance generally should prevail when the purchase of products is considered.

We have a number of industries that are just living proof that they do not seem to prevail in those industries, because our industries in those areas are extremely competitive, much more competitive than the Japanese. Indeed, in some industries the Japanese are approaching us to restrain ourselves at this same time, which is kind of proof of that same pudding.

So I appreciate the expression, and I would be glad to carry it to Japan.

Chairman DOLE. We do not say that with any criticism of the Japanese. I think it is just a matter of fact, we have to address the problem, and we have to urge our own people to be more competitive, but beyond that, we have a responsibility that I think we must address.

I noted in Mr. Dederick's statement that he did not mention the imports that cause the auto industry's problems. Are you suggesting that a 30-percent import penetration has no effect whatsoever on the industry?

Mr. DEDERICK. No, sir, I was not suggesting that. As a matter of fact, I thought I did mention that or at least implicitly as one of the industry's problems.

I would emphasize, though, that we are going through a period where the aggregate automobile market in the United States has weakened dramatically, and so the import aspect of it is merely an additional aggravation. But the basic market has dropped sharply for a number of reasons. We expect this market to improve as 1982 develops, which, as the boat rises, should help us all.

So it is a complex problem. It is a domestic problem and it is an international problem.

Chairman DOLE. You also mentioned trade adjustment assistance in your statement. There is one aspect of it that I understand the administration strongly supports, and that is retraining.

Can it be implied from that statement, or assumed, that the administration still supports a $100 million program in that area?

Mr. DEDERICK. I am not sure because this is an area which is more in Under Secretary Olmer's line, but if I am incorrect in that——

Chairman DOLE. I would preface this by a statement that both Senators Danforth, Moynihan, and others made that argument recently on the continuing resolution. I understand the final figure was $25 million after the conference, but it was never clear what the administration's position was, and that is I think a matter that should be clarified.

Mr. OLMER. Senator Dole, my last recollection of the Department's proposal for trade adjustment assistance was roughly $54 million. I may not be absolutely current on that, but I know that the Secretary supported that level, of course, not all of which would go to automobiles, but a part of it clearly would.

Chairman DOLE. I am advised that was for the firm program, not the worker program.

I do hope we might clarify that because there will be another opportunity when we go back to the reconciliation procedure, and it was the understanding of Senator Danforth and others that there would be that support for the $100 million. We wiped out most of the program, and if in fact that is the case, then we should fund it. I know there are some who have an interest in that.

Mr. OLMER. Well, I would only add, sir, that as you are well aware, this issue is caught up in the fiscal year 1982 budget right now, and it is a subject I believe you are going to have some hearings on.

Therefore, it is an issue that I would like to sort of pass on now if I could because I do not really feel competent to present the administration's view.

Chairman DOLE. Well, there is some urgency if we are going to in fact between now and December 15 have a continuing resolution that may extend to the end of the fiscal year. So we cannot wait for hearings. We just need some expression from the administration so that we can address the problem when it comes before us.

Mr. OLMER. Yes, I understand. I think what I am trying to say is that I am not the one to really make that expression.

Chairman DOLE. Fine.

Thank you, Mr. Chairman. I have no other questions.

Senator DANFORTH. Senator Grassley?

Senator GRASSLEY. Thank you, Mr. Chairman.

First of all I would like to associate myself with the remarks of Senator Danforth and Senator Dole in regard to the seriousness of the situation, and it being more encompassing than just the problem of importation of automobiles. But besides my association with their remarks and no intent to reiterate a position they have taken, I would suggest that traditionally not only between our Governments, the Governments of Japan and the United States, but also between the peoples of Japan and the United States, that there has probably been a friendlier relationship than between almost any two countries except the United States and Mexico, and the United States and Canada, and especially in light of the fact that there has been a rapid increase in productivity of the Japanese since World War II, and particularly because World War II, I think that these friendly relationships are even more spectacular than even the historical perspective, and particularly in relationship to our friendly relations with other countries.

In light of that, I think it is all the more important that we try to emphasize in the strongest terms to the Japanese that the help that we gave them after World War II and helping to redevelop their economy, and how our economies are tied together, and for the economic betterment of both countries we ought to continue to have friendly relations.

I know that probably our Government is attempting to rationalize in these terms; at least I hope they are. But I do not know how better the seriousness of the situation can be brought home to the Japanese Government than to stress these historical friendly relationships, at least in the last 30 years, but more importantly, to emphasize that how long can the friendship be tested in international trade as it is now being tested, going to the historical trade deficits that we have and the need to better those trade relations, particularly in light of the fact that 3 or 4 years ago there were attempts made through negotiations to better those, and in that period of time they have not been bettered at all. They have gotten worse.

The American people can put up with that so long, and then there is going to be some retaliation. That is what we want to avoid because I think the people on this committee know that that is not the best for either country.

Now, in regard to a specific point that I wanted to make, and my question in regard to the 1979 or 1980 agreement on automobile parts, and the reason I emphasize this agreement, it seems to me like it was an early acknowledgement of some necessity for redressing the trade imbalances, and second, it seemed to me to be very specific in the goals it was trying to accomplish, and third, it seems to me that today, with 2 or 3 years of hindsight, it has not accomplished what it was intended to accomplish.

So my question I assume would be to you, Mr. Hormats: Is it true that there is some confusion about the content of the agreement between Japan and the United States calling for greater U.S. participation in the Japanese auto parts market?

In the process of answering that, could you tell me what your understanding or our Government's understanding of that agreement is?

Mr. HORMATS. Well, there is certainly no misunderstanding on our part, and I think if there is any confusion at all, it is perhaps on the part of those Japanese who feel that having taken some action with respect to export restraints, they can virtually ignore the issue of parts purchases or parts licensing or coproduction which we had discussed with them.

The original agreement was that there would be—agreement may be too formalized a word—the original understanding was that the Japanese would reduce and in many cases eliminate their tariffs on auto parts. The other was that the Japanese and United States Governments would jointly sponsor two missions. One was a mission of Japanese firms with an interest in purchasing American-made auto parts, and the second was a mission of Japanese firms interested in investing in parts production, for instance, coproduction or licensing in the United States.

I think it was quite clear what our expectations were, and we were, we thought, clear that the Japanese firms that were involved genuinely wanted to increase purchases of American parts or engage in some sort of licensing or coproduction or investment here.

I can only say that I think they perhaps feel less of a sense of urgency, or indeed, no sense of urgency now. As I pointed out in my testimony, I think that would be a very shortsighted attitude because this is a sector in which the imbalance is quite apparent, as indicated by the figures of $100 million worth of U.S. exports to Japan, $1.8 billion Japanese parts exports here. Not that every sector has to have a balance. I am not arguing that. But I think the fact that it is so hard both to get into their market and to get into the afterparts market, the replacement parts market, illustrates a certain stubbornness on the part of the Japanese and really a certain unwillingness to allow our people who make high quality parts to come in and compete.

We are not just talking about the more sophisticated manufactured parts. We are talking about all parts—tires, hoses and fan belts and batteries, lights, glass. It is a whole array of things. And there is no reason why those American producers cannot sell at least in the afterparts market so that those parts can be used on Japanese cars.

You do not have in the after parts market the transportation costs that impede sales to Japan, you do not have the Japanese tariffs, you do not have the nontariff barriers. There is no reason why we should not be able to participate more in that market.

Senator GRASSLEY. Did you want to answer also?

Mr. OLMER. I would like to add a comment if I might, Mr. Chairman, to that last question of Senator Grassley's.

In the Japanese mind, at least in terms of Government officials, there is no agreement represented by that 1979-1980 negotiation for increasing their purchase of U.S. auto parts. It was in the line of sort of an administrative target figure where they would try to show their good faith and sincerity. To characterize it as a strong desire on their part to increase their access to the U.S. market and bring more goods in I think would be a disservice to those American companies who have tried desperately to allow the Japanese to satisfy such a commitment and have failed to do so.

The Japanese at best were very reluctant to undertake any sort of commitment whatsoever, and I think that is evident in our inability to come anywhere near the $300 million total which was their guidance or target number.

Senator DANFORTH. Senator Roth?

Senator ROTH. Thank you, Mr. Chairman.

Gentlemen, I appreciate your comments, and I think you stated very well what the problems are. Of course, we do face a severe challenge from the Japanese, and unless we correct this problem, we are going to be in even more dire straits in the future than we are today.

If I read your comments correctly, I also tend to agree with your solution, the twofold solution. No. 1, we have to get our economic house in order. Obviously that means deficits down, and interest rates down. High interest rates are one of the main problems in the case of the auto industry as well as in other industries. No. 2, American management must be much more innovative, much more imaginative than it has been in the past.

Notwithstanding your statements and those of Assistant Secretary Hormats, I do think that we as Americans have not been as aggressive and as imaginative as we can and should be in learning Japanese language and customs, and in penetrating that country's markets to the degree we should. We cannot always point the finger and say it is the other fellow's fault; we have to look at ourselves, too, to see how we can do a better job.

Nevertheless, I do think that the Japanese have to live up to their modern responsibilities. To some degree they are getting a free ride. They do not commit as much of their budget to national defense as we do, which means that we as Americans, find ourselves in a relatively more difficult position in enacting the programs, be they credits or direct incentive programs, to get our economy moving in the right direction.

I also think the Japanese are getting a free ride as a result of their greater use of tariff and nontariff barriers. I agree with the chairman of the committee that we should push for fair trade; free trade. Protectionism hurts everyone. But it has to be free, it has to be fair, and the Japanese Government and Japanese business must recognize that they have to reduce those barriers.

It is not only in autos, it is in agriculture—I come from an agricultural State—it is beef, it is grain. We are competing with the unfair barriers that Japan puts up against us. And I understand it is also in tobacco. I understand that the Japanese Government limits 10 percent of its retail tobacco sales to American producers. If we did the same in autos, where would Japan be?

I wondered if you, Secretary Hormats, could explain what we are doing on the tobacco and cigarette sales in Japan, and what the prospects are.

Mr. HORMATS. Yes. In November 1980 there was an agreement reached with Japan, a highly complex agreement, the details of which I do not recall, and certainly do not want to bore the committee with, but basically our exporters have today roughly 1 percent of the manufactured tobacco market in Japan. That market is controlled very tightly by the Japanese. It is called the Japanese tobacco and salt monopoly. How tobacco and salt got in the same monopoly I do not know, but that is what it is called.

That monopoly works basically through a number of steps. It regulates the advertisement of tobacco products, it regulates the number of outlets in the distribution process. There is a formula for pricing which has an adverse impact on the imported tobacco as opposed to domestic tobacco because it tends to create a relatively large differential in the price of imported versus domestically manufactured goods.

What we have tried to do in the overall agreement that was reached in 1980 was to increase our share of the Japanese manufactured tobacco market significantly. So far, although the agreement is still in its early stages, the 1-percent figure that we had in the past is pretty much what is anticipated for this year. There does not seem to be much of an increase.

In addition to that, there is a worry that the formula which is used to compute the prices may lead to an increased differential between imported cigarettes, for instance, and domestically manufactured cigarettes, thus further reducing the U.S. share, even below that 1-percent figure.

So while we believe that on the basis of competition we should be getting a large share of the Japanese market, we feel that this monopoly and the way it works is really holding down the U.S. share considerably. We are pressing very hard, and both Ambassador Macdonald and the Trade Consultation Committee, I think, have been making major efforts to bring this to the attention of the Japan.

I should say personally, as someone who was involved in this earlier, that if the share does not significantly increase, then I think we have to reopen this issue and reconsider the case we had in the GATT which we withdrew when this agreement was worked out in November. If this agreement does not lead to the results that we want, then I think we have to strongly consider reopening the GATT case and making a very strong point of it because it is just another area where we are very competitive and yet find ourselves, through a whole series of encumbrances too bizarre and arcane to fully explain here, a whole series of encumbrances, with a very limited share of that market. And it could get worse rather than better.

Senator ROTH. I appreciate that very much.

I see my time is up.

Frankly, I think, too, that we as Americans have to think anew the degree to which laissez faire re competition, capitalism in our country can deal with other economies which have a different economic underpinning, different economic philosophy. That is the fundamental question I think we have to face and also resolve. And the more that you individually and collectively, based upon your experience and expertise and background, can address that fundamental question and give us the benefit of your views and your thoughts, as well as us talking with you in a dialog, the more I think we are going to solve some problems we have.

Mr. HORMATS. I think you made an excellent point, that U.S. exporters have to be more aggressive and more energetic and invest time and energy in selling; I think you are exactly right. But this is an industry which really has made an effort to do that, and still they are frustrated.

They have the full support of everyone who has worked on this to try to get more access; I know Dave has worked very hard on this. It is a problem which first of all is frustrating.

Senator ROTH. Thank you very much.

[The prepared statement of Senator Roth follows:]

December 1, 1981

STATEMENT OF

U.S. SENATOR WILLIAM V. ROTH, JR.

BEFORE THE SUBCOMMITTEE ON INTERNATIONAL TRADE

SENATE COMMITTEE ON FINANCE

I would like to thank my colleague, Senator Danforth, for convening this hearing on a most critical sector of the domestic economy. The condition of the American automobile industry continues to deteriorate, and we must take a long, hard look at the problems if we are to develop policies -- together with business and labor -- that will stabilize the market for U.S. autos during 1982.

High interest rates, import pressure, low capacity utilization, growing inventories and productivity declines have all conspired to prevent our auto companies -- including Chrysler and General Motors in Delaware -- from regaining health and our auto workers from maintaining jobs.

Despite recent declines in interest rates, the average American family simply cannot finance the cost of a new car. Rates are too high, and few people can afford to write out a car payment check each month which is nearly the size of their mortgage payment.

Import competition, as well, threatens the survival of the U.S. automobile industry. Notwithstanding export cutbacks made by Japan since April, 1981 imports are expected to capture 30 percent of the shrinking U.S. car market.

As imports replace domestic sales, our companies are saddled with mounting inventories and must cut back production.

Statement by
William V. Roth, Jr.
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In fact, by early November, dealers' lots were crammed with 1.5 million units, a supply nearly 35 percent above normal.

The production picture is equally/as bleak. Following a slight surge in May, October's production of autos declined to around 90 percent of the average output in 1967. That is 1967! While the number of drivers in the United States rises, the number of cars they are purchasing is declining in recent months. In response to this slack consumer demand, General Motors and Ford plan to cut output his month. These plans will reduce fourth-quarter production levels to the lowest point since 1959. Rather than advancing with the times, our beleaguered auto industry seems to be backsliding.

Declining output heralds declining employment. As a result of recent cutback plans, indefinite layoffs of hourly paid auto workers are projected to rise to over 190,000 this month. That is in the auto industry alone. Additional cuts will also be necessary in supplying sectors, such as glass, steel and rubber.

To make matters still worse, declining production cripples efficiency and reduces economies of scale in our Nation's plants. At a time when we are facing stiffer and stiffer competition from overseas competitors, losses in efficiency mean higher per unit costs of production and an auto industry incapable of operating successfully in the global marketplace.

Faced with this situation, we in Congress have two choices.

We can encourage the industry's return to profitability, or we can impede progress through ill-advised policies. I believe we have already taken important steps toward encouragement. The Economic Recovery Tax Act signed into law in July, for example, should be a boost to industry, providing needed capital for investment in modernization.

Our workers and firms need every assurance they can get, however, that the market will stabilize. They must be assured that interest rates will not continue to yo-yo up and down, that the cost of inputs will not skyrocket, that recent tax cuts will not be repealed, that Japan will honor its commitment to reduce pressure on the U.S. market, and that new ways will be found to expand export opportunities for American autos and parts.

Only in this kind of atmosphere of certainty and stability will manufacturers be able to make the investments necessary to improve productivity and reduce costs. We in government must provide that certainty.

We must keep in mind, however, that while government has an important responsibility to create the economic conditions that will lead to industrial stability, the public sector can not fight the auto battle alone. Workers and management must help, as well.

Japan can provide an important lesson on the role of business, labor and government in achieving competitiveness for its automatic industry. According to recent estimates, Japanese car makers pay an average of $1,700 less than their American counterparts to manufacture comparable automobiles. Close cooperation between business and labor, sound management practices and governmental policies designed to encourage productivity imporvements have helped Japan surpass the United States in the automotive race.

Some of our manufacturers and labor leaders already seem to have gotten the message from Japan's experience. The Chrysler plant in Newark, Delaware, for example, already produces one of the most competitive front-wheel drive cars in the United States. As a result of wise investment practices by management and wage flexibility on the part of workers, Chrysler has made important inroads into the U.S. smaller car market.

This example of business-labor cooperation should not be lost upon other top executives and workers. Nor should the policies promote such productivity and competitiveness strides should be lost on government.

Business, labor and government, as well as the U.S. consumer are all seeking the same goal -- the restoration of a profitable, stable and internationally strong U.S. automotive industry. I hope today's hearing brings us a giant step closer to that goal.

Mr. HORMATS. Thank you.

Senator DANFORTH. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

This hearing is devoted to the automobile industry. I would first like to say in my judgment, as far as new automobile sales go in the United States, this has nothing to do with our inability to penetrate the Japanese market. Total sales of U.S. automobiles under the most ideal conditions in Japan would be minimal. The problems with the U.S. automobile industry have really been set forth by Mr. Dederick in his statement; namely, the decline in growth rate of the driving age population, the increased cost of automobiles and thus less frequency of purchasing new automobiles, the consumer perception that Japanese cars are of higher quality, and the cost advantage of Japanese auto manufacturers.

Now, it seems to me that the U.S. automobile industry, the manufacturers and labor have been characterized by stupidity and greed over the past 10 years, and I think Mr. Macdonald in his statement is a little optimistic in his statement when he says on his last page that industry has allowed its own labor costs to rise above those that would allow it to retain its market share. Both industry and workers now appear committed to deal expeditiously with the overriding need to restore competitiveness.

We will wait and see what happens.

I notice in the statement by the Department of Commerce that it says that U.S. automobile workers now, except at Chrysler, average $19 an hour, and certainly that is not a competitive wage rate in the United States.

So I think anybody in the industry or labor that thinks that the situation is going to be cured by opening the Japanese market—and I am not sure it is going to come—to new automobile sales is just dreaming. The problem is for the U.S. automobile industry to truly become competitive in quality and price.

Now, as far as the spare parts go, or the parts, I think that is a different question, and I do not quite see why Mr. Macdonald and you folks tiptoe around it so.

Mr. Macdonald, in your statement, on page 6, one aspect of this objective is an examination of alleged Japanese nontariff barriers. There is nothing alleged about it. They are there, are they not? There are Japanese nontariff barriers to our sales.

Ambassador MACDONALD. That was not referring to the auto parts.

Senator CHAFEE. No; but you were referring to nontariff barriers and the removal of these barriers. You are talking of overall of industry, and I do not know why—we have sat through hearing after hearing with you and your predecessors on opening the Japanese market, and always you report back that there is another mission going and an honest attempt is going to be made, but I cannot see, and your own testimony indicates that little, if any, progress is being made.

It seems to me when you have an agreement that we will sell $300 million of parts, I mean, that is a drop in the bucket, and even that is not being honored.

Can we not do something? I mean, there is more to it than a good honest effort. After all, when we have a $20 billion deficit, it seems to me you have some kind of persuasive ability to exercise in these negotiations.

Would you reply to that, Mr. Macdonald?

Ambassador MACDONALD. Yes; I would be glad to.

I think you have given the auto industry, the UAW, and the Reagan administration a bum rap. The industry, I think you would be surprised at the degree of effort not——

Senator CHAFEE. Oh, I admit, now they are making the effort. But they missed the boat. They made a terrible mistake, and now they are trying to scramble back. I appreciate that. As far as the management is trying, they are trying to raise money. We have helped them here with this last depreciation bill and the leasing and the sale of the credits. I am not criticizing the Reagan administration. I am just saying that as far as price and quality, they had better get with it.

Go ahead. I interrupted you.

Ambassador MACDONALD. Yes. They have $70 billion to catch up with. It is a tough job.

You say that there is no way the U.S. auto industry could export to Japan. I would question that. If we were willing to impose the kind of recession cartels, and if indeed they were legal in this country, that the Japanese impose on their industries, and we were to put the U.S. auto industry through a 5 or 8 year recession cartel whereby the Government, with guidance and with the close cooperation of the industry, told General Motors, you make this, Chrysler, you are going to get financed here, these autoworkers will go over here, imports are held in abeyance, I am not so sure we could not come out in 8 years with an industry that would be fighting strong and lean.

But unfortunately, our whole system has been built over 20 years not on that basis. It has been built on a pure free trade basis, some might almost say a unilateral disarmament free trade basis. And as a result we have a situation where they cannot get together even in their own interests and even in a recession. And maybe properly so. I do not pass on the economics of it.

I will leave that subject right there and just go to the efforts of this administration. It is, it has been the same thing for years, you are absolutely right, Senator, and there is one thing I told the Japanese Embassy yesterday when they came in and they said, Where do you want to come out of this meeting, what do you think? More cigarettes? More what? I said, I don't want to walk out with that kind of thing. That is the sort of thing that we have always done in the past. In the past we have always been willing to take a success, walk away, and it is a concrete increase in some sectoral problem. What we would like to do and what we are going to insist on doing is solve the underlying problem and work toward a change in the whole Japanese governmental system that will permeate down through their entire bureaucracy.

That is why this is an interagency delegation. This is not just addressing MITI.

A lot of these trade restraints are not under the jurisdiction of MITI, nor are they under the jurisdiction of the Ministry of Foreign Affairs. They are over in the Agriculture Department, they are in Health and Welfare, and we have to have our corresponding departments working with them while we come in through the Gaimsho, through the Foreign Ministry, and reflect the kind of pressure that you are in fact telling us exists today.

Now, will we be successful? I do not know, but we are not approaching it, in my view, on the same basis that we have approached it in the past because we are not going to walk away with 40 million more cigarettes or something like that. We are either going to walk away with a confidence that the trend concretely is toward market access in Japan, or else we are going to walk away and come back to this Congress and say we are not sure we can operate under the general agreement on tariffs and trade and under the system we have built up since 1947.

Senator CHAFEE. Mr. Chairman, I know my time is up, but I know that last year we did just what you say in the telecommunications. All right, so we made some progress there. And then it is citrus fruit.

What I support is an overall effort as you outline, not solely dealing with the automobile industry or with parts because, in my own mind, the new automobile production in this United States has far deeper problems than inability to penetrate the Japanese market.

Thank you, Mr. Chairman.

Senator DANFORTH. Senator Bradley.

Senator BRADLEY. Thank you, Mr. Chairman.

I would like to ask Mr. Dederick, is it your view that Chrysler is going to make it?

Mr. DEDERICK. As you know, Senator, there is a Chrysler Loan Guarantee Board, and it is this Board which has the responsibility for following the price of the corporation in depth. That is not my responsibility. My responsibility is to be concerned with the broader aspects of the industry.

So I would respectfully say that the answer cannot come from me.

Senator BRADLEY. Let me ask you this, then. If Chrysler runs into trouble in mid-January, and comes back to the Congress, what would be the administration's position? Should the Congress provide more aid?

Mr. DEDERICK. Again, I cannot really act as the spokesman for the Chrysler Loan Guarantee Board. The Board will make a recommendation. The Board is chaired by the Secretary of the Treasury, as you know. It will no doubt make a recommendation.

Senator BRADLEY. Is there a Commerce Department representative?

Mr. DEDERICK. Yes.

Senator BRADLEY. The chief Assistant Secretary for Economic Affairs?

Mr. DEDERICK. That is correct.

Senator BRADLEY. What would you advise that person to do on the Board?

Mr. DEDERICK. I think what I would advise is that we look at all the facts at that time, and make a judgment at that time.

Senator BRADLEY. So you are not ruling out continued aid?

Mr. DEDERICK. I am not ruling out anything because it is not my responsibility.

Senator BRADLEY. Would that conflict, in your view, with your general economic outlook, continued Federal assistance to Chrysler?

Mr. DEDERICK. I think my basic view is clear that I do not believe that it is the responsibility of Government to intervene in individual company situations. The fact remains that the Government has intervened in the Chrysler situation before this administration took office. There have been various commitments made, various amounts of funds have been made available, and so forth, at that time that have not all been drawn upon. So we have a fait accompli.

Senator BRADLEY. But you would not approve of an extension of guarantees?

Mr. DEDERICK. Philosophically, I would be opposed to that, but I am not going to impose my philosophy upon any particular individual situation. I think that situation has to be looked upon as itself, and in that context I would not make a judgment at this time.

Senator BRADLEY. I pose this question more generally to the group. Last year, two-thirds of the automobile sales in this country were small cars. Last year, the industry said it needed roughly $8 billion to retool so that they could produce a sufficient number of small cars by 1985.

Sales of automobiles are at the lowest point on an annualized basis since the 1920's. Given present levels of sales, and the revenues from those sales, where is this industry going to get the capital to finance this shift to small cars, and what in your view is the Government's role in this process?

Mr. DEDERICK. Speaking for myself, Senator, the administration's macroeconomic program which calls for a return to a noninflationary economy with rapid growth, if past experience is any guide, will give great benefits to the automobile industry, which is a major segment. In addition, the specific aspects of the program which we have mentioned.

We know how much they need. We know they have been making a considerable effort to get it. We know there are sources available to them. There are external borrowings. I am convinced that if the industry can show a viable growing performance over the next several years, that the markets will be willing to give it the funds it needs.

Senator BRADLEY. I think that you have just made a statement that illustrates of one of the fundamental conflicts of the program. You said that if things go well over the next several years, they will be able to get sufficient capital. That is a long range view.

But the question that was implicit in my first question to you about Chrysler is: Is there a short-range undertow that will take this industry and even the economy under before we get to that long-range future?

Mr. DEDERICK. I wish I were a better economic forecaster than I am. I fully agree that there is a short-range undertow. We are in a recession. The automobile industry has been one of the major sufferers in this recession. This recession is not going to end tomorrow. It has months to go.

Senator BRADLEY. How many more months, would you say?

Mr. DEDERICK. Sometime, I would say, within the first half of the year we will probably reach the trough.

Senator BRADLEY. What do you think unemployment will be?

Mr. DEDERICK. We have an unemployment rate of 8 percent now. It certainly should move somewhat higher than that. We have heard estimates of 9 percent, this would be based on sort of past experience, and I will not argue strongly with it.

My point is that it is our belief that the economy will be coming out of this recession no later than the second half of the year, and we will be entering a recovery. That is not a very long time period ahead.

Senator DANFORTH. Senator Dole.

Chairman DOLE. I just wanted to make a few concluding observations for the record. There are certain responses that can be proposed in the event that everything else fails, and of course one is section 301 of the Trade Act of 1974, which does permit the President to withdraw trade agreement concessions, or to impose tariffs and quotas in response to restrictions on U.S. exports. So that is available.

We have section 48 of the Internal Revenue Code which permits the President to deny investment tax credits with respect to articles produced in a country which unjustifiably restricts U.S. exports. That is an area that we might want to explore.

There is a provision in the communications bill passed by the Senate, S. 958, providing that the FCC can refuse to license communications equipment produced in a country which does not grant reciprocal access to its markets, and that is another remedy that we may want to focus on.

Then there is the general agreement on tariffs and trade and the technical codes negotiated in the recent MTN's which provide the U.S. Government with the mechanism to seek relief from Japanese unfair trade practices that nullify U.S. benefits under the GATT. If such practices are not corrected, this country can impose increased tariffs or quotas or withdraw other concessions. The administration can bring many more cases under the GATT and its subsidiary technical codes.

There are other areas, and I again suggest in a friendly spirit, that we must address, that the Congress must address, that this committee must address, if what I consider to be a firm policy of this panel and this administration fails.

I would say to the panel, and to those who will be making the trip next week, that this responsibility is not lost on this committee, and we intend to pursue it.

Thank you.

Senator DANFORTH. I would just like to add that I totally agree with Senator Dole.

Ambassador Macdonald, you asked the question earlier, "Will we be successful?", and you said you didn't know. There is one thing that I am reasonably sure of, and that is if you are not successful, we will be successful. I really think that last spring things looked pretty good for getting something through the Congress, and I think that they look better now.

Nobody likes protectionism. Everybody would like to adopt the more leisurely approach of Mr. Dederick and let Reagonomics work, and I hope it does. But we are not going to just watch major industries sink below the horizon on the mythical theory of some free-trade arrangement with Japan. The quixotic, unilateral pursuit of the free-trade myth is not going to sustain an opposition to saving major industries when they are in fact threatened.

So I wish you well. You will get a resolution of the committee supporting your efforts and stating our views. If there are any clearer ways for us to state them, fine, we will do it. But we are getting beyond the point of just stating positions and banging our fists on the table, and hoping for the best.

We are getting to the point where major industries are threatened, and we will do what is necessary to save them; and it is just as simple as that. The idea that at a time of recession, a $10 billion bilateral trade deficit is increasing to a $15 billion deficit is not just a freak economic event, that is a major change in the trade relationship between the two countries. If that deficit begins to go to $20 billion and $25 billion, and on up to $50 billion as the Commerce Department has indicated, that is not acceptable, that is not free trade, and it will not happen.

We can't accomplish objectives by the extreme subtleties of these prolonged negotiations, and the winks and the nods, and the placid understandings that we hope, maybe, we have achieved with the Japanese—only to find out that we have achieved nothing at all.

We cannot accomplish any objectives that way. There is one way to do it that is very simple, relatively fast, and extremely clear, and that is by statute. That is what we do in the Congress, we pass statutes, that is what we really know how to do, and believe me we will do it.

Thank you very much.

Senator BRADLEY. Mr. Chairman, may I ask one more question before the panel leaves?

Senator DANFORTH. Certainly.

Senator BRADLEY. In the statement of Senator Danforth, which I would generally echo, there is the assumption that the critical issue for the trade balance is the bilateral balances with various countries, and that we should always keep our eyes on these bilateral balances.

I wondered if you could comment on this point. Do you believe it is the bilateral or the international balance that is the critical factor? While there is a very serious threat from Japan, that could be met ultimately in the Congress by the type of legislation that Senator Danforth spoke of, and Senator Dole spoke of, do you think the bilateral balance question is really a short-term issue.

Isn't there the danger that during prolonged negotiations with the Japanese over how has how many cigarettes come in and what nontariff barrier prevents them from coming in, and so forth, the Japanese are laying the groundwork for an enormous export expansion in the Pacific Basin in the 1980's and 1990's. Our eyes may be fixed on the wrong ballgame.

So my question to you is, in addition to the bilateral trade questions, have you in your discussions with the Japanese explored the possibility, of opening up those areas of the fastest growth potential for U.S. markets, and making sure that the Japanese do not freeze us out of those areas.

Ambassador MACDONALD. Senator Bradley, with respect to the bilateral trade imbalance, that is in our view a result, number one. It is not a cause in itself, it is a result of lack of market access in Japan.

There is no question that any trade official should look to the overall balance of the United States. In some cases you may find rather prominent imbalances for one reason or another that are offset by other positive balances.

Market access, we believe, and are convinced, is the cause of this particular imbalance. In that case, we have just addressed ourselves to the market access in Japan as the primary obstacle to our relationship.

Senator BRADLEY. My point is that while the debate is going on on market access, even if you get some of those nontariff barriers reduced next year or 2 years from now, you may believe you are achieving a victory, until you see that the real U.S. growth market, in the next decade, is not the internal Japanese economy, but rather it is the Pacific Basin where the Japanese are laying a strong groundwork for exports.

I fear we have invested no real efforts to lay the groundwork for that area of growth. We have fought all our battles on that bilateral issue with Japan on access to the Japanese domestic market because that is the most pressing political need.

Ambassador MACDONALD. That isn't quite true. We are willing to compete with the Japanese on equal terms in any third country in the world. Ambassador Brock, I think spent 3 or 4 weeks in those ASEAN countries, which as you say, are among the most rapidly developing economic areas of the world. We are working on our exports to those areas.

Senator BRADLEY. It is your view that there is a potential market for U.S. goods there? Does the greater potential lie with the Japanese economy, knowing what we know about their maturing economy, homogenous culture and resistant political process, resulting in very difficult negotiations? Or is it the Pacific Basin that offers the greatest growth potential for U.S. exports?

Ambassador MACDONALD. I am not sure, and we just don't want to leave out any possibility.

Senator CHAFEE. Mr. Chairman, let me just say one thing, if I might.

My remarks about the U.S. automobile industry and its problems are unrelated to the overall problem of the Japanese nontariff barriers. I don't think that the U.S. automobile problems are going to be solved by the removal of those, but I am extremely anxious that those nontariff barriers be removed for spare parts and a host of other things.

If we end up with a $20 billion deficit, with fair competition, sobeit, that is life. But I want our industries to be able to compete fairly. So I join in the remarks made by Senator Danforth on the deep concern that this panel feels about the inability or the unwillingness of the Japanese to permit our products to compete fairly there.

Thank you.

Senator DANFORTH. Thank you very much.

The next witnesses are Sheldon Friedman of the UAW, and Steve Koplan of the AFL-CIO.

Mr. Friedman, would you like to proceed?

If we could have some quiet in the room, it would be appreciated.

STATEMENT OF SHELDON FRIEDMAN, DIRECTOR OF RESEARCH, UAW, DETROIT, MICH.

Mr. FRIEDMAN. Senator Danforth, I welcome the opportunity to be with you today. With me is Gene Casraiss of our legislative department in Washington.

I don't want to burden you with too many more depressing figures about the state of the U.S. auto industry. Let me just tell you that for the latest period for which figures are available, domestic car sales are absolutely dismal.

The November 11 through 20 period reflected a decline of some 30 percent compared with an already depressed 1980. At an annualized rate, sales were running at 5.3 million cars per year, the lowest level since 1959. The prolonged slump in which we now are mired is in its 32d month.

No sooner did the 1982 models start rolling off the lines than the economy plunged into the current recession, causing production schedules for the fourth quarter of this year to be slashed 21 percent below an already depressed 1980.

Calendar year 1981 car production will turn out to be less than 6.3 million cars, the lowest level since 1961 in this country. Let me put that figure into perspective, to give you some idea of the magnitude of the current crisis. Since 1961, the population is up 25 percent; the number of drivers has increased 75 percent; the car fleet is up 79 percent; and the growth in real GNP has been 124 percent.

The recession that has been triggered by the tight money policies of the Federal Reserve System, we believe, runs the risk of killing the patient in an attempt to cure the economy's disease. Clearly, although the Federal Reserve is an independent agency, tight money is one of the articles of faith of Reagonomics.

Massive unemployment has been the result of all of this. In the auto industry alone, we have witnessed a decline of some 250,000 production jobs since 1978, which is a 32-percent reduction. The Transportation Systems Center mentioned earlier by the Government panel has estimated that the reduction in manufacturing jobs since 1978 as a result of the auto crisis has been some 600,000, with another 600,000 conceivably on the line between now and 1985.

Workers, faced with this devastating unemployment, have seen their TRA slashed. We estimate that some 90 percent of the 250,000 autoworkers receiving TRA previously have lost that benefit. I think they will be surprised to learn from the earlier spokesperson of the administration that in fact this cutback was designed to help them and not hurt them.

In Michigan just last week, we learned to our shock that as a result of changes in the unemployment insurance extended benefits program enacted by Congress during the summer, that the extended benefits in Michigan triggered off, and in Michigan we have had unemployment in double digits since January of 1980.

The continued severe slump has robbed the Nation of much of the benefit that otherwise would have accrued from the first year of import restraints under the 3-year Japanese voluntary program.

I think it is important to recognize that the Japanese are continuing their worldwide export push at a time when sales in their home market are lower than a year ago. If you look at the first 9 months of 1981, their exports worldwide have increased to 55.5 percent of production, compared with 51 percent in 1980. Their penetration in several major markets of the world has increased compared with a year ago by some 41 percent in South America, and 63 percent in Africa.

We believe that the time has come for renewed U.S. vigilance on this subject. We are especially concerned that pressure is needed to assure that the Japanese in fact honor the first year commitment to restrain exports to the United States to 1.68 million passenger cars per year.

At the time the restraint was announced, we felt that figure was far too high. You may recall that in March we testified before your subcommittee that a more appropriate figure would have been 1.2 million based on a base period of 1975 through 1979. Had that in fact been the established ceiling, it would have meant something like an additional 100,000 manufacturing jobs.

What we have gotten in this country is far too little and far too late compared to other major industrialized automobile producing nations of the world. If you look at Italy, they limit imports of Japanese cars to 2,200 vehicles per year. France has a strict 3 percent market share limitation. Britain, 10.8 percent. Germany, 10 percent. I could go on.

Even the 1.68 million figure raises concerns in terms of whether it is going to be met. The figures for the first 6 months of this year don't inspire confidence that it will be. So far, according to the Japanese Auto Manufacturers Association, 905,000 cars have been exported to the U.S.; that leaves no more than 774,000 for the October through March period, which would be 12 percent less than a year ago, and 14.4 percent less than in the restraint's first 6 months. This suggests to us that further pressure on the Japanese may well be needed.

With respect to the second year, there are a number of unresolved questions that we would like to see clarified right away. In particular, what is the base period going to be, to which the 16.5 percent adjustment will be applied. Moreover, it is not too soon to begin discussions with respect to the third year ceiling.

There is a great deal more that I would like to cover. I see that you are about to gavel me to a stop.

Let me just say, with respect to parts trade, there have been skyrocketing imports of auto parts into the United States. The situation is going to get very, very much worse unless appropriate remedial action is taken.

We believe that the solution that is needed is a local content requirement for this country. This is really the only way to assure that the major multinational auto companies that dominate the world market will, in fact, act responsibly to invest here and create jobs here where they enjoy such a vast market.

Thank you for giving me a few extra seconds.

[Statement of Mr. Friedman follows:]

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SUMMARY OF STATEMENT OF SHELDON FRIEDMAN ON RECENT DEVELOPMENTS IN THE U.S. AUTOMOBILE INDUSTRY

* The state of the U.S. auto market is dismal, with devastating effects on auto workers, and the outlook for 1982 is rather dim.

* The continuing depressed state of the U.S. auto market, due first to tight monetary policies of the Federal Reserve and more recently to the onset of what looks to be a severe and prolonged recession, has robbed the nation of much of the benefit that otherwise would have resulted from the first year of Japan's voluntary export restraint commitment.

* With respect to Japan's voluntary program of export restraint:

    * Export plans for the balance of this fiscal year should be carefully scrutinized, and other steps taken, if necessary, to assure that Japan, in fact, will meet the first year ceiling it announced.

    * Concerning the second year of restraint, several issues are in need of clarification; discussion of these issues should be underway.

    * It is not too soon to urge Japan to continue restraint in the program's third year; discussion of this matter should not be deferred until the end of the second year, but should instead commence right away.

    * Compared with most other auto producing nations, what the U.S. got from Japan was too little and came too late.

* With respect to auto parts, the nation's balance of trade with countries other than Canada has deteriorated over the last decade from a position of significant surplus to one of significant deficit. Unless appropriate steps are taken, further widening of that deficit is on the way.

* The U.S. should take a cue from Japan and adopt an industrial policy geared toward reviving the nation's sagging industrial base.

* For the long term, local content legislation is needed in auto. Such legislation would require auto multinationals to invest capital and provide jobs where they enjoy a major market. It would provide U.S. consumers with the range of product offerings they want and give U.S. companies the competition they need — while shoring up the industrial and employment base.

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**STATEMENT OF
SHELDON FRIEDMAN, RESEARCH DIRECTOR
INTERNATIONAL UNION, UAW
BEFORE THE
SENATE FINANCE SUBCOMMITTEE ON INTERNATIONAL TRADE
ON
RECENT DEVELOPMENTS IN THE U.S. AUTOMOBILE INDUSTRY**

December 1, 1981

My name is Sheldon Friedman. I am the Research Director of the International Union, UAW. I appreciate the opportunity to present the UAW's views on recent developments in the U.S. auto industry on behalf of our 1.3 million members.

UAW President Douglas Fraser last testified before this Subcommittee on March 9, 1981 in support of S. 396, sponsored by Chairman Danforth and 21 other Senators, to restrict Japanese auto imports. Largely as a result of the momentum behind that bill, on May 1 the Japanese government announced a three-year program of voluntary restraint of its car exports to the U.S. Japan declared that those exports during their 1981 fiscal year (April 1, 1981 to March 31, 1982) would be held to 1.68 million cars, 7.7% below the level of calendar 1980. For the 1982 fiscal year, the export ceiling will be increased by 16.5% of the "expansion of the market," according to Japan's communique announcing the restraints; the time periods being compared for purposes of determining the second year ceiling were left unspecified. Japan's initial commitment did not include a third-year ceiling; continuance of restraint during the third year will be "discussed at the end of the second year," according to Japan's May 1 announcement.

Unfortunately, beleaguered U.S. auto workers have benefited relatively little from the Japanese commitment. Domestic auto sales have remained extremely low, and there is little evidence to date that Japanese exports have been significantly curtailed.

The number of laid off workers has been rising again in recent months. Over 181,000 auto workers are presently laid off indefinitely at the five prime auto companies alone. Compared with their 1978 hourly workforce, the number of workers presently on indefinite layoff represents an employment reduction of 19% by GM, 25% by Ford, and by Chrysler, 44%. In view of attrition since then, even these figures understate the extent of actual employment loss; according to the Bureau of Labor Statistics, during October 1981, there were 250,000 fewer production jobs in the motor vehicle industry than in 1978, a decline of 32%. Including the impact on supplier workers, the U.S. Department of Transportation (DOT) recently estimated that roughly 600,000 manufacturing jobs have disappeared from the nation's "auto-related employment base" since 1978; the same DOT study projects that an additional 600,000 jobs could disappear from the industry by 1985.

On October 1 thousands of these unemployed auto workers were hit by drastic reduction — or total loss — of their trade adjustment assistance benefits. As the UAW will testify at greater length to this Subcommittee next week, the gutting of worker trade adjustment assistance breaks a solemn compact government made with labor that, as trade liberalization was pursued, workers injured by imports would at least be compensated.

Tens of thousands of other unemployed auto workers have not only exhausted their TRA allowances but their unemployment insurance as well, as a result of the duration of their joblessness, compounded for many by the recently-enacted, heartless slashing of extended unemployment benefits. Prospects for finding a satisfactory job are bad and rapidly getting even worse. Unemployment rates in major auto producing states are in, or rapidly approaching, double-digit figures. Nationwide, the unemployment rate jumped from 7% in July to 8% in October — and has been predicted to go to 9½% (by a Joint Economic Committee economist) before the current recession subsides.

At various times in the continuing 33-month slide there were optimistic signs. On several occasions, sales rates recovered somewhat; in each case, rapidly rising interest rates or a surge in import sales choked off recovery just as it got underway. Soon after the 1982 models started rolling off the lines, the economy plunged into the current recession; the annual domestic car sales rate plummeted from a dismal 7-million to an abysmal 5-million annual rate. With a record 81½-day inventory on dealers' lots on November 1, fourth quarter 1981 domestic auto output is being slashed 21% below the depressed level of fourth quarter 1980; anemic production plans have also been announced for the first quarter of 1982. Adding in the fourth quarter, 1981 domestic production will be below 6.3 million cars, the lowest level since 1961. To put that figure into perspective in order to better understand the magnitude of the present crisis, it should be noted that in the intervening 20 years, the nation's population has risen 25%, the number of licensed drivers is up 75%, the fleet of cars on the road has grown 79%, and real GNP is up 124%.

Production during the fourth quarter will be at the lowest level since the fourth quarter of 1959.

With any subsequent improvement dependent upon the state of the economy, the outlook for the current 1982 model year is grim. Even before the probable dimensions of the current recession had become clear, the average of eleven private forecasts of 1982 model year sales of domestic makes was a meager 7.5 million cars. Though that would represent some improvement compared with model year 1981's disastrous sales of 6.6 million domestic makes, such a figure would still be nearly one-fifth below domestic sales of the last really good model year, 1978. Moreover, the onset of what looks to be a prolonged and severe recession makes it increasingly unlikely that sales of 7.5 million domestic cars during the 1982 model year will be achieved.

The monetary policy pursued by the Federal Reserve — with support from the Administration — deserves much of the blame for the current recession and renewed auto sales decline. The Fed has restricted the growth of money and credit to rates well below the rate of inflation. Since much less can be bought on credit than a year ago, sales of durable goods such as cars and housing have fallen. Moreover, resulting weakness in the economy has depressed income growth and the consumer confidence needed to buy autos and other big ticket items.

Furthermore, our high interest rates have raised the value of the dollar, making imports cheaper and exports less competitive. The high dollar also makes the U.S. a less attractive site for new productive investment by foreign and domestic companies.

The recent slip in interest rates reflects the current steep recession rather than a more expansionary Fed policy, which continues to act as a brake on economic expansion.

Japanese Commitment to Restrain Auto Exports

The Japanese commitment to restrain auto exports came after a two-year export push. In early 1979, with gas lines in the U.S. in the wake of the Shah's demise, world oil prices soaring and the yen tumbling, the government and companies of Japan launched a major export drive that included autos. The Japanese share of the U.S. car market rose from 12% in 1978 to a record 21% in 1980, while domestic car sales plummeted, reflecting a rapid swing in consumer buying patterns toward smaller, more fuel-efficient cars.

Under those emergency conditions, the UAW sought U.S. government intervention to obtain a commitment from Japan to restrain exports. In February 1980, UAW President Douglas Fraser went to Japan at the invitation of Senator Mansfield, U.S. Ambassador to Japan, and Ichiro Shioji, president of the Japan Auto Workers federation. In Japan, Mr. Fraser met with the heads of major Japanese auto companies and the late Prime Minister Ohira to present the Union's case for export restraint.

During the trip, Toyota announced that it would curb exports to the U.S., yet their U.S. sales continued to increase. In June 1980, with the Japanese share of a shrinking market continuing to grow and auto worker unemployment reaching crisis proportions, the UAW filed a Section 201 petition for import relief with the International Trade Commission (ITC). The Commission agreed that increased imports were indeed causing great injury to the domestic industry, as the Escape Clause of the General Agreement on Tariffs and Trade requires for import restrictions. However, applying the more restrictive U.S. law, a three-to-two ITC majority found that the industry had been injured by other causes even more than by imports.

In contrast to the ITC's ruling, other countries with large auto production took decisive action to curb Japanese imports well before their domestic industry suffered injury to the extent that the U.S. industry has. Italy's limit of 2200 autos per year from Japan dates from the 1950's. Disturbed by a couple of years of relatively modest rises in Japanese auto imports, the French and British drew the line in 1978 on Japanese penetration of their markets, Britain at 10.8% of its domestic market, and France at just 3%. Germany and the Benelux countries received commitments of export restraint from Japan about the same time the U.S. did. At that point, Japanese penetration stood at only 10% of the market in Germany. Most recently, the Japanese companies have been committed to halt their shipments of pickups and light vans to Britain starting in August through the rest of the calendar year. Shipments from January to July this year had almost equaled the total for all of 1980.

S. 396, setting an import quota of 1.6 million Japanese cars a year, was introduced in January of this year. As this Subcommittee was taking action on that bill, Japan announced its export restraint.

An interim evaluation of the restraint, now that only four months remain in the program's first year, raises concerns of which this Subcommittee should be aware. The rate of exports through September, if continued for the full year, would substantially exceed the announced export ceiling of 1.68 million. That first-year commitment can be met only if the rate of exports is cut substantially in coming months.

Both the U.S. Commerce Department and the Japan Automobile Manufacturers' Association (JAMA) have been monitoring Japan's auto exports to the U.S. (For details, see Attachment 1.) Because Commerce must wait for cars to enter the U.S., its data presently can only be used to gauge the restraint's first four months. JAMA's export data cover the first six months. Commerce counted 642,691 car imports in the first four months — higher than JAMA's count for the same four months of 1980 (633,081). JAMA shows fewer exports than Commerce for those four months, but still finds only a minimal reduction from the comparable months of 1980 to 631,868. The JAMA data for the six months April through September show exports of 905,223 this year compared with 921,496 last year, a drop of just 1.7%. Even if JAMA's figures — rather than those of the Department of Commerce — are correct, to stay within the commitment, Japan must export 12.1% fewer cars during the six months from October through next March than it did a year ago, and 14.4% fewer than during the restraint's first six months.

We are very pleased that the Commerce Department is monitoring the Japanese commitment. If their numbers continue to run higher than the JAMA numbers, we hope that the U.S. government will deal with the Japanese government on the basis of its own evidence. Whichever set of numbers turns out to be correct, we urge this Subcommittee to do whatever is necessary to assure that Japan abides by the first year export ceiling it announced.

The time has come not only to insure that the first year commitment is met but to discuss the second and third years of the restraint. Discussions are needed to determine the exact procedures to be used in computing the second year ceiling. Moreover, in contrast to the language of Japan's May 1 communique, we should not wait until the end of the second year to nail down details of the third year of restraints.

This is particularly important, in view of past experience with voluntary export restraint by Japan. Japan volunteered to hold auto exports to the U.S. in fiscal 1978 to the same level as fiscal 1977; the expiration of that commitment was immediately followed by the unprecedented surge in exports of spring 1979. Moreover, the 1978 commitment was made only after several months of exceptionally high exports had both boosted the fiscal 1977 reference level and swelled inventories.

During fiscal 1978 the yen reached historic highs. By March 1979, at the end of that year of export "restraint," U.S. inventories of Japanese cars were once again extremely high. The fortuitous circumstance of gas lines in April turned those record inventories into record retail sales in record time.

The Europeans have also had difficulties with Japan's export restraints. The British arrangement on autos has been a constant tug-of-war since 1978. For example, Prime Minister Thatcher was compelled to criticize excessive Japanese exports in interviews during the Tokyo Summit of 1980.

Auto is by no means the only industry where such problems have arisen. In the last year, the European shipbuilding industry has complained that, after several years of compliance, Japan has unilaterally abandoned the pact made with European shipbuilding nations for mutual reduction of capacity and sales. The fact that Japan continues to run record trade surpluses both with Europe and the United States at a time of widespread recession and high unemployment is exacerbating international economic tensions among the major industrial nations.

U.S. Auto Parts Trade

Largely neglected in public debate to date, trade in automotive parts deserves far more attention — and remedial action. Imports have made inroads in the auto parts industry from three directions. First, the domestic parts industry has lost sales of original equipment parts as domestic vehicles have been displaced by imported vehicles. Second, U.S. vehicle assemblers have been using an increasing proportion of imported parts. A panel of experts predicted this year that U.S. vehicle assemblers would import 15% of their parts by 1990 (in a survey conducted by Arthur Andersen & Co. and the University of Michigan). Third, foreign-made parts have had an edge in supplying the market for replacement parts for foreign vehicles. Presently, there are some 19 million imported cars on the nation's roads — over 18% of the total fleet. As the recent bulge in imported new cars gets older, imports of replacement parts will grow.

Parts imports from countries other than Canada have mushroomed, albeit from a rather low base, rising by 702% between 1970 and 1980. Exports of automotive parts are also up substantially, but have not risen as much — with the result that the U.S. auto parts trade balance with countries other than Canada has gone from substantial surplus to substantial deficit over the last decade. (For details, please see Attachment 2.) With major new investments in engine plants and other automotive parts facilities soon to come on stream in Mexico — largely as a result of that country's export requirements — parts imports are likely to increase rapidly in the years ahead; much the same can be said of Brazil.

In connection with this issue, it should be noted that the U.S. and Mexico recently established a joint working group on problems of automotive investment and trade. Pursuant to a recent request of the Administration, the UAW is in the process of developing recommendations for the U.S. negotiators. Our recommendations will be particularly directed at certain of Mexico's export policies and will be designed to assure that these policies do not result in further worker dislocations in the U.S. We will be glad to share our recommendations with this Subcommittee, and hope you will give them consideration and support.

With respect to Japan, in the fall of 1980, a group of Japanese auto company representatives toured the U.S. in a much-publicized "buying mission" for U.S.-made parts. Coming during the public debate over the case of auto import relief then pending before the ITC, the trip's timing suggests that it was intended to convey the impression to the American public that trade between the two countries could be carried out on a more equitable basis. Many of us were skeptical that the mission would have much practical effect. At the conclusion of the mission, Japanese auto companies promised to substantially raise their imports of U.S. auto parts and indicated that their goal was to import $300 million worth in 1981.

However, according to data provided us by the U.S. Department of Labor's Office of Foreign Economic Research (OFER), U.S. exports of auto parts to Japan in fact have increased very little, if at all. OFER figures show exports in the first half of 1981 of only $30.4 million, compared to $26.6 million in the same period last year and $60.8 million for all of last year. Discounting for inflation, U.S. auto exports to Japan apparently will be little, if any, higher this year than last.

Meanwhile, Japanese auto parts exports to the U.S. continue to soar. Our auto parts imports from Japan last year were valued at about $1.3 billion and, according to OFER estimates, appear to be running 20% ahead of last year.

No discussion of the problems of automotive parts trade would be complete without noting the inadequacy of current data. We need tabulations on U.S. auto parts trade with every country, not just Canada, Japan and Germany. We believe this Subcommittee can assure that such data gets tabulated and would be pleased to offer a specific recommendation in more detail.

The Need for a Coherent Industrial Policy

The U.S. has been slow in learning that almost any of its industries can be displaced as a result of the industrial policy of the Japanese government. Japan can acquire the world's best technology in virtually any industry it targets, and nurture that industry by assuring credit, fostering research and development, and protecting the domestic market until it is ready to compete internationally. As has been extensively documented, this was the pattern in auto. It seems only a matter of time, probably within the decade, before what has already happened to auto and other U.S. industries will be repeated in the office equipment, computer, and aerospace industries as well.

The U.S. economy can suffer greatly when imports displace a domestic industry and the workers in that industry cannot be readily transferred to other productive employment. As the massive unemployment in auto-dependent states attests, that has been one result of the jump in auto imports of the last few years.

If the U.S. economy is ever to regain reasonable growth in output and productivity, our government policy must take some cues from Japan. The aerospace industry provides a recent example of how the Japanese government very successfully coordinates investment, trade and technology acquisition to assure growth in key industries. When it bought $4 billion worth of F-15 fighters from McDonnell Douglas and PC3 patrol planes from Lockheed in 1978, the Japanese government negotiated to have 40% of their value locally produced. Over the course of the production run, the Japanese companies will gradually assume the bulk of production.

The civil aircraft story is more complex, but even more revealing. The Japanese government coordinates domestic arrangements and international negotiations of the Civil Air Transport Development Corporation of Japan, comprised of the heavy industries segments of Fuji, Mitisubishi, and Kawasaki. The government granted over $80 million in subsidies (covering half of development costs) to the consortium when arrangements were made with Boeing for the Japanese to produce 15% of the value of a new generation of planes. In-recent months, the Japanese government and the consortium have been negotiating with Boeing, McDonnell Douglas and Airbus of Europe for further joint participation in new aircraft projects.

The Need for Local Content Legislation in Auto

Only a handful of auto companies supply the bulk of the U.S. and world auto markets. Over the next few years, their decisions about where to locate production will affect the livelihood of millions of Americans. The U.S. Department of Transportation has estimated that U.S. production of automobiles, from materials to components to assembly, requires 2.2 million American workers, even at the current reduced output level. Millions of other Americans depend on the income paid to those workers, and the spending it creates, for their livelihood in sales, distribution, service, the professions and government.

A local content requirement is needed to preserve employment in the auto industry and its suppliers, and shore up the nation's sagging industrial base. A content law would require that automobile manufacturers with large sales volumes in this country invest here and provide jobs here. It could also deal with the problem of the export abroad of auto industry-related jobs by domestic manufacturers. Auto manufacturers, including the Japanese, would have to maintain a high ratio of U.S. value-added (i.e., production and employment) to U.S. sales. The content requirement should be tied to sales volume and be phased in over a reasonable period of time. Credit could be given for exports of parts or vehicles, to allow manufacturers flexibility to rationalize production.

The UAW believes that every auto company which has substantial sales volume here, has an obligation to generate employment here. Sales in North America by VW, Toyota, Nissan, and Honda have long since reached a level at which full-scale assembly can be efficiently accomplished here. Indeed both Toyota and Nissan have U.S. sales that approach Chrysler's.

Substantial local content cannot be implemented overnight. But the timetable carried out by Volkswagen over the last few years can serve as a clear example for others. VW began U.S. production in 1978. Now, in addition to its assembly plant in Pennsylvania, it has a stamping plant in West Virginia and a new multi-plant complex in Texas. It is about to open a second assembly plant in Sterling Heights, Michigan. Currently, the North American content of VW Rabbits is approaching 70%.[1]

As noted earlier, Japan has imposed local production requirements for its aerospace purchases. A local content law is clearly superior to long term measures which simply limit imports. The competition among the world's auto companies to provide the American consumer with a wide variety of innovative products built with the most efficient technologies available would be retained. The U.S. producers would continue to be pressured by the discipline of the design and engineering innovations of foreign-based manufacturers. Local content requirements would, however, lead to increased investment in our country and prevent further disastrous loss of jobs. Such jobs would be not only in motor vehicle assembly, but in the many firms and industries which supply the auto industry.

A local content law in auto would represent a clear and consistent U.S. government policy aimed at preserving and inducing investment in the American economy. Compared with the cost of simply letting the auto-centered U.S. industrial base crumble, such a policy would be sound supply-side economics indeed!

Thank you.

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attachments

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1. Honda has announced it will operate a small car assembly operation in Ohio by 1982, and Nissan has announced assembly of small trucks in Tennessee within a few years. It is not anticipated that domestic content of vehicles manufactured at either plant will be very high; nor has any other Japanese manufacturer announced plans for large-scale direct investment in the U.S.

ATTACHMENT 1

JAPANESE PASSENGER CAR EXPORTS TO THE U.S.

	Commerce	JAMA	
	1981	1981	1980-1981
April	173,278	169,881	158,908
May	153,331	155,411	149,573
June	153,214	144,766	162,023
July	162,868	161,810	162,577
August		123,727	139,233
September		149,628	149,182
October			147,286
November			142,091
December			146,737
January			167,475
February			150,517
March			127,699
April-June	642,691	631,868	633,081
April-September		905,223	921,496
October-March			881,806
April-March			1,803,302
Balance of 1.68 million for October 1981 to March 1982		774,777	
As percent of October 1980-March 1981		87.9%	
As percent of April-September 1981		85.6%	

SOURCE: International Trade Administration, Department of Commerce; Japan Automobile Manufacturers' Association (JAMA)

ATTACHMENT 2

U.S. AUTOMOTIVE PARTS TRADE, EXCLUDING CANADA

	IMPORTS* (000)	EXPORTS (000)	BALANCE (000)
1970	$570,106	$951,807	+ $381,701
1971	748,654	942,371	+ 193,717
1972	1,034,181	1,014,651	- 19,530
1973	1,386,852	1,246,335	- 140,517
1974	1,726,136	1,808,653	+ 82,517
1975	1,531,659	2,321,737	+ 790,078
1976	2,155,801	2,496,571	+ 340,770
1977	2,761,382	2,543,279	- 218,103
1978	3,767,952	2,484,004	- 1,283,948
1979	4,258,999	3,156,421	- 1,102,578
1980	4,572,342	3,882,764	- 689,578

* Adjusted for Japanese trucks misclassified as cab-chassis before August 1980.

SOURCE: Tables 2I and 7E, Automotive Trade Statistics, 1964-1980, U.S. International Trade Commission Publication 1171.

Senator DANFORTH. Thank you, Mr. Friedman.
Mr. Koplan.

STATEMENT OF STEPHEN KOPLAN, LEGISLATIVE REPRESENTATIVE, AFL-CIO, WASHINGTON, D.C.

Mr. KOPLAN. Thank you, Mr. Chairman.

My name is Stephen Koplan, and I am a legislative representative with the AFL-CIO. I am accompanied by Elizabeth Jager, trade economist in our department of economic research.

I will not read my entire statement, Mr. Chairman, but I would ask that it appear in its entirety in the record.

The AFL-CIO welcomes this opportunity to comment on the developments in the automobile industry since April of 1981.

Last year the AFL-CIO reported that nearly 1 million Americans—autoworkers and businessmen, drivers and dealers, cafeteriaworkers and electronic assemblers, electricians and patternmakers, steelworkers and machinists, rubberworkers and glassworkers, and many other types of production and serviceworkers—have been affected by the devastation in the U.S. auto industry.

In 1980 the auto recession has worsened. Sales of U.S. cars will be about 6.2 to 6.6 million, down over 30 percent from 1978, the lowest figure in 20 years. Mid-November sales for the big three auto manufacturers, GM, Ford, and Chrysler, were 29.8 percent below the period a year earlier.

The 1982 model year is off to one of the worst starts in history. Imports, recession, tight money, and lack of effective purchasing power, continue to compound U.S. industry problems. The loss of American jobs, wages, benefits, and the livelihoods they represent have affected cities and towns and even State governments across America. The time for action is long overdue.

In March 1981, the AFL-CIO and the UAW appeared before this subcommittee to support as a step forward S. 396, a bill introduced by you, Mr. Chairman, together with 21 other Senators, to restrain by law the number of cars imported into the United States.

At that time, the AFL-CIO urged imposition of a quota of 1.2 million imports of Japanese autos per year. In addition, we urged inclusion of a domestic content requirement to assure that we have a healthy auto industry, and not one that merely assembles parts manufactured overseas. Assembly facilities do not constitute an auto industry as the experience in the developing countries has shown. We suggested that such a content requirement could be phased in up to 75 percent by 1983.

Finally, we recommended immediate action to limit the import of parts. Events since April of this year have heightened the urgency of our recommendations of last March. The virtual destruction of trade adjustment since then has heightened the tragedy.

The recent AFL-CIO convention set forth a detailed antirecession program, and called for credit allocations to offset the effects of tight money policy on industries like autos.

In May 1981, the Japanese Government announced that it would take a modest step. In commenting on the voluntary program, UAW president Douglas Fraser made clear that the numerical limit of 1.68 million cars to be imported between April 1981 and

April 1982 was too high, that specific limits should be mandatory for 3 full years and should be monitored tightly by the U.S. Government.

Auto parts are continuing to flood into the United States from Japan. The increase continues, up about 20 percent since the concerns about these problems were raised last year. Parts also continue to come to the United States from Mexico, Brazil, South Korea, Hungary, Romania, and many other countries of the world where the United States has neither access to the market, nor a two-way arrangement on investment.

As the U.S. market sagged, and the U.S. exports of auto parts to Japan declined from 74.2 million to 72.1 million in the first 8 months of 1981, the U.S. imports of Japanese cars and parts increased. In fact, U.S. imports of auto parts from Japan rose from $745 million in the first 8 months of 1980 to $968.7 million in the first 8 months of this year.

The flood of parts from Japan does not result from the fact that U.S. parts cannot be sold. In fact, U.S. exports of parts to countries other than Japan expanded in this period. This rise in U.S. exports of parts to countries other than Japan may be a function of their temporary need for such parts. Once these countries have developed their own strong auto industry, including parts production, they will restrict U.S. exports of parts.

Last year in September, the Japanese sent a buying team to the United States and made commitments to reach a target of $300 million of imports from the United States. In September of 1980, there was much ado about the big export market. U.S. labor was interested in any sales we could get, but noted that even three times the $300 million amount would not make up for the massive losses we were then experiencing. I appreciated hearing one of the Senators comment this morning that the $300 million is only a drop in the bucket.

The fact is that a sagging market in the United States could not be expected to absorb more imports. But the expanded production in Japan, to use added capacity and export to the world, should have been able to absorb more U.S. parts. This is not fair trade or a fair deal, and the commitment, however vague, has not even been reached by the Japanese.

Instead of investment to help build an effective auto industry, or to join with U.S. firms to improve the U.S. industry at home, we note that Nissan, for example, has propagandized U.S. reporters with false and racist commentaries about the incompetence and lack of productivity of the U.S. workers. There is a quote in my testimony from the Washington Post on that, Mr. Chairman.

Japanese investment in the United States continues. Japanese investment in U.S. auto production is virtually nonexistent, except for assembly facilities. Nor do the Japanese plans for worldwide investment show that they have provided for any U.S. share in the massive after market that exists in auto parts for Japanese cars.

For every Japanese car that is sold in the United States, there will be a need for a continued supply of parts for repair. Neither American companies, which are quite able to produce parts adequately, nor Japanese firms are producing such parts in the United States for Japanese car dealers. Nor are there plans for this. In fact, the Japanese have reportedly been reluctant to license production to U.S. firms on the grounds that they have to meet warranty requirements.

The problem of auto parts becomes all the more accute because the United States stays open and the rest of the world limits imports. Japan, unlike Italy, no longer has quotas on auto imports. But it has so many ways to avoid imports, and such a strong national bias against imports of U.S. and European cars, that the sales to Japan from the rest of the world are minimal.

For these reasons, Mr. Chairman, we restate our request for a program of local content, monitoring of imports of autos and parts, a quota of 1.2 million imports of Japanese autos per year, and a quota on parts until the U.S. industry is back on its feet.

Thank you for your patience, Mr. Chairman.

[Statement of Mr. Koplan follows:]

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SUMMARY OF
STATEMENT BY STEPHEN KOPLAN
LEGISLATIVE REPRESENTATIVE, DEPARTMENT OF LEGISLATION,
AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS,
BEFORE THE SUBCOMMITTEE ON TRADE, SENATE FINANCE COMMITTEE, ON
DEVELOPMENTS IN THE AUTOMOBILE INDUSTRY AND THE
U.S. MARKET FOR AUTOMOBILES SINCE APRIL 1981

December 1, 1981

I. The auto recession has worsened. Imports, recession, tight money and lack of effective purchasing power compound U.S. auto industry problems. Action is needed as the situation worsens. Effects on parts and related industries had cost nearly one million jobs by December 1980 and more are now affected. The U.S. government should act.

II. The AFL-CIO restates it recommendations of last March calling for a three-year quota of 1.2 million on imports of Japanese cars per year, a phased-in 75 percent local content requirement, and monitoring and limitation of imports of parts. The AFL-CIO Convention in November of 1981 also set forth a detailed anti-recession program including new credit and monetary policies.

III. Japanese actions since April of 1981 have not proved adequate:

(a) Their limitation on exports of cars to the U.S. of 1.68 million units for the first year (April of '81 to April of '82) was much too high.

(b) U.S. parts sales to Japan were lower in the first eight months of 1981 than in the same period last year.

(c) Japanese auto investment in the U.S. has not developed but the Japanese are investing in countries where productivitiy is lower and trade barriers are higher than in the U.S.

IV. The U.S. does not get a fair share of aftermarket trade in parts.

STATEMENT OF STEPHEN KOPLAN
LEGISLATIVE REPRESENTATIVE, DEPARTMENT OF LEGISLATION,
AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS,
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In 1981, the auto recession has worsened. Sales of U.S. cars will be about 6.2 - 6.6 million -- down over 30 percent from 1978 -- the lowest figure in 20 years. Mid-November sales for the "big three" auto manufacturers (GM, Ford and Chrysler) were 9.8% below the period a year earlier. The 1982 model year is off to one of the worst starts in history. Imports, recession, tight money and lack of effective purchasing power, continue to compound U.S. industry problems. The loss of American jobs, wages, benefits and the livelihoods they represent have affected cities and towns and even state governments across America. The time for action is long overdue.

In March of 1981, the AFL-CIO and the UAW appeared before this Subcommittee to support as a step forward, S. 396, a bill introduced by Subcommittee Chairman Danforth together with 21 other Senators to restrain by law the number of cars imported into the U.S.

At that time, the AFL-CIO urged imposition of a quota of 1.2 million imports of Japanese autos per year. In addition, we urged inclusion of a domestic content requirement to assure that we have a healthy auto industry and not one that merely assembels parts manufactured overseas. Assembly facilities do not constitute an auto industry, as the experience of developing countries has shown. We suggested that such a content requirement could be phased-in up to 75 percent by 1983. Finally, we recommended immediate action to limit the import of parts. Events since April of this year have heightened the urgency of our recommendations of last March. The virtual destruction of trade adjustment since then has heightened the tragedy.

The recent AFL-CIO Convention set forth a detailed anti-recession program, and called for credit allocations to offset the effects of tight money policy on industries like autos.

In May of 1981, the Japanese government announced that it would take a modest step. It stated that it would implement the following three year program to limit the export of passenger cars to the U.S.:

1) In the first year (April '81 - April '82), the export of passenger cars to the U.S. would be limited to 1.68 million units.

2) In the second year (April '82 - April '83), the level of 1.68 million units would be increased by 16.5 percent of any expansion of the U.S. market in the first year.

3) In the third year (April '83 - April '84), no commitment on exports to the U.S. was made other than to review and discuss whether restrictions should be continued.

In commenting on the voluntary program, UAW President Douglas Fraser made clear that the numerical limit of 1.68 million cars to be imported between April of 1981 and April of 1982 was too high, that specific limits should be mandatory for three full years and should be monitored tightly by the U.S. government.

When the AFL-CIO appeared before this Subcommittee in March we quoted a statement by Ralph Millet, representing the Automobile Importers Association in response to a query about increased Japanese capacity:

> "The increasing capacity in Japan is probably for components such as transaxles, engines, transmissions and what not, items that are being ordered by domestic companies for production in the United States.
>
> "Toyo Kogyo, for example, is supplying transaxles. Isuzu Motors is supplying diesel engines. Mitsubishi is supplying engines for Chrysler."

Thus, auto parts are continuing to flood into the United States -- from Japan. The increase continues -- up about 20 percent since the concerns about these problems were raised last year.

Parts also continue to come to the U.S., from Mexico, Brazil, South Korea, Hungary, Romania, and many other countries of the world where the U.S. has neither access to the market, nor a two-way arrangement on investment.

As the U.S. market sagged and U.S. exports of auto parts to Japan declined from 74.2 million to 72.1 million in the first eight months of 1981, the U.S. imports of Japanese cars and parts increased.

In fact, U.S. imports of auto parts from Japan rose from $745 million in the first eight months of 1980 to $968.7 million in the first eight months of this year.

The flood of parts from Japan does not result from the fact that U.S. parts cannot be sold. In fact, U.S. exports of parts to countries other than Japan expanded in this period.

This rise in U.S. exports of parts to countries other than Japan may be a function of their temporary need for such parts. Once these countries have developed their own strong auto industry -- including parts production -- they will restrict U.S. exports of parts.

Mexico for example, has an elaborate system to assure that Mexico will develop a strong, healthy, technologically advanced automobile industry. It imports parts until they can be produced in Mexico. The Mexican government has decreed that the United States firms and other foreign investors must produce and export parts from Mexico in a balanced fashion. The result has been a shift of industry to Mexican production at a cost of U.S. jobs and production.

The Japanese example, the Mexican development and the rise of many other similar programs world-wide means that the United States must adopt a local content provision to assure that cars will be built in the United States and that we will not lose the automobile industry. Import monitoring and regulation are urgent necessities until the U.S. auto industry is on its feet.

Last year in September the Japanese sent a buying team to the U.S. and made commitments to reach a target of $300 million of imports from the United States. In September of 1980, there was much ado about the big export market. U.S. labor was interested in any sales we could get but noted that even three times the $300 million amount would not make up for the massive losses we were then experiencing.

The fact is that a sagging market in the U.S. could not be expected to absorb more imports. But the expanded production in Japan -- to use added capacity and export to the world -- should have been able to absorb more U.S. parts.

This is not fair trade or a fair deal. And the commitment -- however vague -- has not even been reached by the Japanese.

Mr. Fraser had a second point in his statement about the Japanese program in 1981 when the Japanese announced restraints on exports:

> "Despite these shortcomings, the restraint agreement acknowledges the basic principle made repeatedly by the UAW that Nissan, Toyota and other Japanese automakers have taken unfair advantage of the crisis in the U.S. auto industry."

But acknowledgements of basic principles don't guarantee action. Instead of investment to help build an effective auto industry or to join with U.S. firms to improve the U.S. industry at home, we note that Nissan, for example, has propagandized U.S. reporters with false and racist commentaries about the incompetence and lack of productivity of the U.S. workers, according to the Washington Post of September 13, 1981:

> "...His somewhat sour view of American workmanship is one reason Nissan has shied away from building cars in the United States, although the company is willing to try its hand at trucks."

"...He dismissed a reporter's suggestion that Sony has managed to get high-quality production in its San Diego electronics plant. Ishihara argues that TV set manufacture is simpler than making a car -- and notes that, in any event, there is a high percentage of Asian workers in the San Diego Sony plant."

Meanwhile, Nissan has gone ahead with plans to develop facilities in European countries, for example, where productivity is much lower. In Italy, only a few thousand Japanese cars are allowed to enter the country each year,. and productivity is low, but Nissan is going there.

According to The Economist of July 11, 1981, Nissan has established a manufacturing base in Mexico, where it is now spending a further $400 million to expand production of cars, engines and other components for export to North and South America. It has also started work on a $300 million plant in Tennessee to make pick-up trucks for the American market. In Australia, Nissan is spending $100 million expanding its production facilities, including a big new engine foundry to supply castings for Japan as well as for the local market. The Economist also reports:

"In Europe, Nissan has acquired a 37-percent stake for around $30m in Motor Iberica, the Spanish truck firm. It has also signed a $15m joint venture with Alfa Romeo to manufacture 60,000 cars a year ~~to~~ in Italy. It has even announced plans to make a Volkswagen model in Japan. In Britain, Nissan says it will build a $600m plant for assembling up to 200,000 cars a year."

"Honda announced plans back in January, 1980, for assembling cars for the American market at Columbus, Ohio, close to its existing motorcycle plant. Production is scheduled to start next year at an initial rate of 40,000 cars a year, building up to 120,000 units annually."

Japanese investment in the U.S. continues. Japanese investment in U.S. auto production is virtually nonexistent except for assembly facilities.

Nor do the Japanese plans for world-wide investment show that they have provided for any U.S. share in the massive $1 billion or more aftermarket that exists in auto parts for Japanese cars. For every Japanese car that is sold in the U.S. there will be a need for a continued supply of parts for repair. Neither American companies, which are quite able to produce parts adequately, nor Japanese firms are producing such parts in the U.S. for Japanese car dealers. Nor are there plans for this. In fact, the Japanese have reportedly been reluctant to license production to U.S. firms on the grounds that they have to meet warranty requirements.

This reality -- the failure of the influx of Japanese cars to be met with growth in U.S. production of parts for Japanese cars -- compounds the injury now being experienced in cars and parts production in the United States.

The AFL-CIO believes that the United States cannot continue to pretend that the rest of the world is open, when the realities are that foreign governments make decisions to assure production of autos and parts within their borders and the U.S.-based and other multinational firms comply with those rules to transfer production there and export to the United States.

In March, the AFL-CIO made available to this Committee a report on the various provisions for local content and for production within the borders -- either by law or de facto -- in many countries of the world. Several witnesses in March told this Subcommittee that the French were limiting imports of Japanese cars to 3% of their market, and that the British had an agreement for 10%. The Italians have a limit allowing only about 2,000 Japanese cars a year to enter Italy.

The problem of auto parts becomes all the more acute, because the United States stays open and the rest of the world limits imports. Japan, unlike Italy, no longer has quotas on auto imports. But it has so many ways to avoid imports and such a strong national bias against imports of U.S. and European cars, that the sales to Japan from the rest of the world are minimal.

For these reasons, Mr. Chairman, we restate our request for a program of local content, monitoring of imports of autos and parts, a quota of 1.2 million imports of Japanese autos per year, and a quota on parts until the U.S. industry is back on its feet.

Senator DANFORTH. Thank you very much.

With respect to Japanese investment in automobile production or parts production in the United States, it is virtually nil, yet they talk a good game. I notice that the Governor of Missouri was over in Japan on a trade mission a couple of weeks ago. Apparently he was talking with them, and they held out the prospect of building some sort of plant in our State of Missouri. I have just heard the same thing so often. Some day we will do something. They all come back and we feel wonderful about it, and then nothing happens.

With respect to the productivity of the American worker, it is my understanding that the Japanese have invested heavily in Mexico. They have invested heavily in Spain. Do you believe that the American worker is less productive than the Mexican worker or the Spanish worker?

Mr. FRIEDMAN. To pose the question is to answer it. Obviously, American workers are vastly more productive than in those two countries mentioned. Indeed, American autoworkers, we believe, are still perhaps the most productive in the world. If we have been edged out by Japan, it is not that substantially, and it is because of the very depressed conditions that exist in our industry, which has meant operating rates of some 60 and 65 percent of capacity, which is no way to achieve productivity.

Senator DANFORTH. Do you think that we have just had it as a country? We are just in a decline, and we are never going to pull out of it? The Japanese are just running circles around us, and they have better products, and better skills, and better workers? Is that the story, or is there hope?

Mr. KOPLAN. Mr. Chairman, obviously my answer to that question is, no. Is there hope, yes. I think that if we start from where we were last March, with S. 396. Your comment this morning that the time for simply talking about these things and pounding the table and complaining about it has passed. There is need for action by this Congress to do something about this, rather than just talk about it.

If we can resume where we left off last March, having looked at what has happened since that time, obviously we feel that something can be done. We have made recommendations. We would continue to be happy to work with you along this regard. We know that you are serious about the issue. But there has to be something done by the Congress, or nothing will be done. If nothing is done here, then I think there is no hope.

Senator DANFORTH. Senator Dole.

Chairman DOLE. I had to step over to another committee meeting briefly.

I was impressed with what I consider to be a rather solid front in the administration position this morning. At least there seemed to be a firmer position, a more determined position, than I have heard here for several years. You may or may not agree with that, knowing your inclination to be against anything in this administration, but I think it is a point worth noting.

I would hope that you would support the administration in their efforts, and I assume you will, is that correct?

Mr. KOPLAN. Which efforts are those? Are you referring specifically to this issue, Senator Dole?

Chairman DOLE. I think Mr. Olmer recited a number of areas where he flatly indicated that the problem was the Japanese. The interagency task force that will go to Japan next week. I also recited a number of things that Congress could do, and I made those a part of the record.

I am not prepared at this point to say that nothing will happen unless Congress does it. I am prepared to give this administration at least a chance to make some inroads and to open up the Japanese markets, and I would hope that this is the view you have.

I did not mean that we should slack in our resolve to address the problem, but it is certainly a factor that must be considered.

Mr. KOPLAN. I think we are always willing to give somebody a chance to make inroads, as you are suggesting. But I have to go back to the hearings that were held here last March, and the discussions that took place with the Japanese. What came out of all that, after a clear signal had been sent from the Congress that there was a mood in this Congress to do something very specific, hopefully in a very positive fashion—what came out was a voluntary program by the Japanese that would limit their export of cars by units to 1.68 million in the first year.

Then after that there is no way you can define what they have in mind with regard to the second or the third year. The second year is extremely vague. The third year, there were no promises made. What we have suggested is a 3-year program to help get the American industry on its feet.

Having waited since March, and looking at the situation now, looking at the latest set of statistics, we think that the time for these discussions may have passed, and that the time is for the Congress to act now. What is happening in the interim is that thousands of additional workers are losing their jobs.

What has happened in the interim is that something like trade adjustment assistance has been slashed from $1.5 billion to about $300 million, and of that $300 million, the $100 million in training that you were asking about this morning, Mr. Chairman, is not even in the legislation any longer. It came out because the bill has been vetoed.

You asked the question as to what the administration's position was on that $100 million. My recollection is that shortly before the vote there was a letter from Secretary Donovan asking that $98.6

million be included in the continuing resolution. Unfortunately, that request arrived in the Appropriations Committee after the subcommittee had already acted, and the wheels were turning. It became increasingly difficult to get that training money in, as you are well aware. But there was a specific administration request for the money.

Even with that money, there is virtually no trade adjustment assistance program any more. So while we see this flood of imports continuing——

Chairman DOLE. That is not a solution to the problem.

Mr. KOPLAN. No; it is not.

Chairman DOLE. Maybe we could moderate the wage demand next year, that might be helpful, too. But you don't want to get into that at this hearing, I assume. It is going to be another factor. We can't all come in and say, "It is the Government's fault we have these problems. We have got to have strict import quotas, and higher wages for domestic workers."

To me that does not address the problem at all. We are going to look at the $100 million and see if, in fact, that should be included.

My only point is, I think you said earlier that Senator Danforth and others on this committee are very serious about our responsibilities. We are very concerned about a lot of unemployed workers. We would rather focus on how to get them back to work, than how to appropriate more money for some program for unemployed workers. I think that that is what you want us to do. You want us to find ways to increase jobs.

Mr. KOPLAN. That is correct, Senator.

Chairman DOLE. We are going to put the pressure on this administration as it has never been done before, and we are in a position to do that. We just want your help.

Mr. KOPLAN. We would be glad to help in that regard, Senator Dole. I would say, we all know that there is a history in this town that when there is a problem, and the people are concerned about it, the easiest way to make a problem go away is to appoint a task force or a commission, or whatever. Then, we wait a year for the results of that.

I don't think that in this industry we can afford to wait any longer. We have waited since March or April to see something positive develop, and instead it is just getting increasingly worse, increasingly worse, and nothing is going to be accomplished unless there is a strong signal coming out of this Congress that there is an intent to immediately do something for this industry, and for the workers in it.

Chairman DOLE. I hope we made the record indicate that this was our intent this morning.

Mr. KOPLAN. Yes; I think you have.

Chairman DOLE. We did not say that it would be immediate, but we did not talk about it being 10 years down the road either. We made it rather clear to those who are going to Japan next week that they are invited to come back, but hopefully with some results.

Senator DANFORTH. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Friedman, I listened to your statement with interest, outlining what you term as a "dismal" situation in the industry. You had some specific suggestions as far as auto content, and continuing the import quotas.

What does the UAW propose to do to help?

Mr. FRIEDMAN. I think the UAW has always been very responsible in its bargaining with the auto companies, if you look historically over a long period of time. It is true that we have negotiated excellent wages and benefits, and in fact we are very proud of having done that.

But it is also the case that the productivity level in that industry was very high, rose faster by far than the rest of manufacturing in our economy over a very long period of time. It was a very profitable industry.

Senator CHAFEE. Let's take the present situation, and not the past. We are right up here now in 1981 and going into 1982.

Mr. FRIEDMAN. Frankly, Senator, I believe the workers in our industry, the members of our union are prepared to take a number of steps to save their jobs, but they don't feel, and I think they are right to feel, that it really is not within their power to save their jobs at this point in time. They need some direction from the Federal Government, some clear signal that the industrial base of this country is not going to be allowed to go down the tube.

Senator CHAFEE. Do you think that the testimony given earlier by one of the administration witnesses that one of the problems involving the Japanese cars is the question of price and quality. Setting aside quality, do you think that prices are the reason the Japanese have achieved over 30 percent of penetration of the U.S. market?

Mr. FRIEDMAN. Not to a significant degree.

Senator CHAFEE. You don't think it is?

Mr. FRIEDMAN. No, sir.

Senator CHAFEE. Then why are Americans buying Hondas, Toyotas, and Datsuns in such overwhelming numbers?

Mr. FRIEDMAN. I believe that the Japanese automakers had the right product at the right place and at the right time. They had record stockpiles, record inventories in March 1979, at a time when the car buying-public had switched back to larger cars, during a period of declining gasoline prices in this country.

Senator CHAFEE. Why are they buying them now?

Mr. FRIEDMAN. There is no question that they are excellent automobiles.

Senator CHAFEE. But price is not a factor?

Mr. FRIEDMAN. It is not to a significant extent a factor.

Senator CHAFEE. What makes the people buy them, then. After all, we are selling Horizons now, Escorts, all kinds of competitive automobiles. I don't think that the people who buy them are necessarily buying their second Japanese because they bought one in 1979.

Mr. FRIEDMAN. To some extent that may be the reason. There is a psychology of marketing, Senator. Once a consumer has bought a car, and has been satisfied with it, regardless of what development has taken place in the market, they may stick with that type of car.

The domestic manufacturers have at long last been coming out with some of the products that they should have come out with a long time ago. They are not making that point felt by the American public. Many of the car buyers have become satisfied with a Japanese car.

Senator CHAFEE. So you don't think that it is price or quality?

Mr. FRIEDMAN. I would be less than candid if I did not agree that certainly several years ago they had a superior product with respect to some dimensions of quality. With respect to many of those dimensions, there has been considerable improvement among the American manufacturers. Nevertheless, it may well be that to some extent a gap remains. There are other dimensions of quality such as safety, on which our vehicles are definitely ahead.

Senator CHAFEE. Do you think that they are better advertisers than we are, and that they are out-selling us because of their advertising?

Mr. FRIEDMAN. I think they are very skilled in utilizing the advertising resources of this country.

Senator CHAFEE. Do you agree with the statement of the American International Automobile Dealers Association, which is going to testify after you, that says that the problems of the U.S. auto industry are largely due to poor management methods.

Then it goes on in the middle of page 12:

> U.S. auto companies agree. Chrysler's vice president for quality and productivity, George F. Butts, says, "The biggest problem is the management system." The director of technical planning for Ford, William J. Harahan, says, "The resolution of the problem is 80 percent a management responsibility and 20 percent a production worker responsibility."

What is the matter with our management?

Mr. FRIEDMAN. I think you should ask them that question.

Senator CHAFEE. You are pretty close to it. You deal with them.

Mr. FRIEDMAN. We often don't agree with things that they do. But where was the Government's responsibility in the quote you read, Senator? That added up to 100 percent with no public role at all.

Senator CHAFEE. The who?

Mr. FRIEDMAN. The governmental role. The figures that you quoted to me added up to 100 percent.

Senator CHAFEE. You think that it is the governmental responsibility?

Mr. FRIEDMAN. I think that it definitely is.

Senator CHAFEE. In what respect?

Mr. FRIEDMAN. In respect to preserving the industrial base of this Nation, and protecting employment.

Senator CHAFEE. But you just testified that the Japanese don't excel in either price or quality; so that leaves us with advertising as the source of their competitive edge—is that right?

Mr. FRIEDMAN. No, sir. I said that they build excellent cars, and they have gained a major foothold in our market through very aggressive strategies.

Senator CHAFEE. My time is nearly up, let me ask you a final question.

Is UAW prepared to do its part in trying to solve this problem? For instance, I am specifically talking about the forthcoming wage negotiations.

Mr. FRIEDMAN. I believe, Senator, that that is definitely the case. We have indicated clearly we understand that this is a crisis period for the auto industry, and our No. 1 priority is the job security of our members.

Senator CHAFEE. I should think that your No. 1 priority would be the health of the industry, and thus the jobs for your members, rather than job security. You want not only the jobs you have got, but you want more jobs, don't you?

Mr. FRIEDMAN. Absolutely.

Senator CHAFEE. You have a lot of people on lay off.

Mr. FRIEDMAN. We sure do.

Senator CHAFEE. Thank you, Mr. Chairman.

Chairman DOLE. Senator Bradley.

Senator BRADLEY. Thank you, Mr. Chairman.

Could you give me your best guess as to what percent of the automobile industry's problems today are caused by trade problems, and what percentage are caused by economic conditions generally, and particularly interest rates?

Mr. FRIEDMAN. It would be difficult to attach an exact percentage. I would implicate them at this point approximately equally. If you look at a good automobile year, we are more than 3 million cars and trucks below a good year, and we have had sharp increases in imports during the same period that the market was plummeting by those 3 million-plus units.

So if you want a rough estimate, I would call it half and half. In fact, at the present moment, we are really afflicted more by the problems of the recession, that is the No. 1 problem that we are faced with at this point in time.

Senator BRADLEY. When you say at this time, you mean the next 6 to 8 months?

Mr. FRIEDMAN. Yes.

Senator BRADLEY. The question is whether you are going to survive; isn't that it?

Mr. FRIEDMAN. Right.

Senator BRADLEY. The GM plant in Linden, N.J., for example, last week just laid off a thousand workers. The reason those workers were laid off, if my information is correct, is because there are no sales of the cars that they are producing. The sales are related to the fact that sales generally are down because of the economic condition. Is that correct?

Mr. FRIEDMAN. Yes, sir.

Senator BRADLEY. Where do you say the industry is going to get this $80 billion that it stated it needed to make the retooling to the smaller car reality by 1985?

Mr. FRIEDMAN. The scary thing is that they seem to be trimming back that figure. The companies themselves don't see how they are going to get it, it would appear, and they are greatly scaling back those plans. They have deferred or canceled plans to renovate and build a number of new plants. I think they have basically concluded that they are not going to get that kind of financing, and that the industry in the future is going to be substantially smaller in this country, unless something is done.

Senator BRADLEY. I would like for you to talk a little bit, if you can, from the perspective of your membership, because I know in my conversations with members of the UAW or the AFL-CIO, this issue of transitional assistance is a fairly significant one, not only because Congress more or less made the commitment that this will be there if you go along with the GATT agreements, but because suddenly there is a real feeling of breach of faith on a number of issues.

What I would like to have you do, if you could, is to share with the committee a little bit of what you think of the human concerns and how that translates into your own problems as a labor union in trying to get people to pull together in difficult times.

Mr. FRIEDMAN. Senator, I heard a heart-rending story this week. One of my colleagues was on jury duty, and he reported to a judge who told him of the drastic increase in economic crime in the Detroit area, much of it clearly related to the massive unemployment we are faced with. In one case, an unemployed autoworker had taken his children into a supermarket, made sandwiches there, fed them with the sandwiches, and got himself arrested.

The magnitude of the human tragedy that we are faced with as a result of the auto crisis, I could not do it justice by giving you a quick answer to that question. The kinds of programs that are needed, the kinds of job creation, the kinds of human services, instead of being provided, are being cut. So the tragedy is being compounded by the heartless actions of the administration.

Senator BRADLEY. I don't agree with the administration's policies either, but I don't think they are heartless, between you and me.

The issue is, how can you get across the human problem here, because that is what is out there with these thousand workers in Linden, N.J., that have lost their jobs. Things are not going to just happen. There is not going to be a new booming industry to grow up there tomorrow. What is going to happen to these workers?

Could you, in the remaining 10 seconds, share with us here your general philosophy of what is important for the America economy to grow in the 1980's.

Mr. FRIEDMAN. The free market solution is no solution. It will not solve the kind of catastrophic dislocations we are faced with in industries like auto. We need comprehensive Government planning that would target employment creation.

A State like Michigan has 55 percent of its manufacturing employment directly related to the auto industry. It is absolutely massive in Michigan, and other Midwestern auto-dependent States, and there is nothing on the horizon that would step in to fill that vacuum if that industry is allowed to go down the tube.

Senator BRADLEY. Thank you.

Senator DANFORTH. Senator Roth.

Senator ROTH. Thank you, Mr. Chairman.

I see one slight note of optimism on the part of the Ford Motor Co. president, Donald Petersen, who said that by year-end, if the economy is growing at a 4- to 5-percent rate, and if the prime interest rate is below 15 percent, we should have a new car sales rate of over 10 million units, and truck sales of 3 million.

We have some economists here, I wonder if that would tie pretty much with your predictions.

Mr. FRIEDMAN. Senator, that prediction is not as rosy as it may appear on the surface. Once you probe beneath it that 10 million figure includes imports; I believe Mr. Petersen's projection included about 2.5 million imports. So that means 7.5 million domestic cars. That would represent an increase to be sure.

Senator ROTH. How much?

Mr. FRIEDMAN. It would be on the order of 7 percent above 1981. It would be still perhaps 20 percent below the last good year, 1978.

But as the administration testified earlier, and I think their projections are more accurate than those of the Ford Motor Co. at this point, because of the intervening recession. The projection you just read to me was made before it was clear what was happening to the total economy. Subsequent to that, you would have to adjust downward your projection. I think 7.5 million domestic cars is unlikely to be achieved in 1982. The administration earlier in their projections bore that out.

Senator ROTH. Let me start out by saying that I happen to be of school that this country must have a viable automobile industry, must have a viable steel industry and other basic industries, if we are to continue to be a major power with a strong economy, if we are going to be able to provide security.

One of the things that has interested me the most is how do we get better cooperation among Government, business, and labor in this kind of a problem. I see here Mr. Petersen talks about, "We have to replace 'sticker shock' with 'sticker surprise' together with our employees, and the UAW leadership. We have to bite the bullet, and we have to do it now." He goes on to mention some things that he feels the union people should do. I sit here and listen to some of the things that you feel management should do, and what Govenment should do.

My question is, how do we get away from the adversarial relationship where we try to blame the other party for our economic woes, and really sit down and work together in trying to hammer out long-term solutions.

There is a lot of sympathy for developing cooperative solutions on the part of the union leadership. I have talked with Mr. Fraser on this matter in the past. I have talked with management. One of the great advantages in Japan is that you don't have the adversarial relationship that we have in many ways deliberately tried to develop in the past, and it had, I suppose, certain advantages. At the same time, it does seem to be putting us at a competitive disadvantage.

How can we get a stronger working relationship not only at the top but all the way down through management and union. Would anybody care to comment on that?

Mr. FRIEDMAN. Senator, I believe in the waning months of the Carter Administration there was an attempt to establish tripartite cooperation between industry, labor, and Government. UAW supported that effort, we felt it was long overdue.

But it strikes me that the present administration is philosophically opposed to the kind of concept that you just outlined. We, in fact, believe it would be desirable to have meaningful tripartite cooperation to help solve the problems that confront American industry. If we felt that it was to be meaningful, we would participate in such a program. But I don't think that is in the cards with the kind of administration we have.

Senator ROTH. What bothers me is that there is always the tendency to blame some other party. I think it is critically important, if we are going to work our way out of our economic malaise that we devise some means and methods of working together, because otherwise I think we have some tough competition in the long term.

Ms. JAEGGER. I agree with you, Senator. I think most of the labor leadership does, as Sheldon Friedman just said. I think, however, that the point that we are so concerned about is not coming through here. We are not saying that this one did that wrong, or that one did that wrong, and the other one did the other thing wrong—labor, management or Government.

We are saying that the Government has the responsibility, and labor is perfectly willing to play its role. But part of the governmental responsibility is to enforce the trade agreements and the laws of the United States, which make it perfectly possible to act in this situation right now.

Consequently, it seems to me that the attitude that the Japanese have that people in the United States seem very reluctant to face is that they have a sense that altogether they have an obligation to have Japan have industries.

We are here today, while people say, we want to make sure we have industry, the question is, How? We are suggesting one mechanism. We don't for a moment think that trade is the only method, but the problem is that all of the other answers are always raised as the only solutions, and somehow no one wants to do anything about trade because we have what Senator Danforth calls, a mythological view of how the world works. I think this is a very, very serious problem.

I don't think that there is a lack of cooperative spirit among American workers. Most of the plants in the United States operate with relatively amicable relationships. I think it is a shame that our adversary system is translated into a battle in the public dialog.

I finally said to a Japanese group not long ago, "You know, to listen to you all talk, you would think that everybody gets up every morning on the union side, and tries to see how they could hold up production." This is simply not the way American industry functions, or the way collective-bargaining functions. I think it is unfortunate that this image is being projected to the Japanese. They have very bad disputes among themselves. They don't all agree on everything, but they don't advertise it the way we do.

In short, I think that it is very appropriate for us to look at the trade solutions, not as a final or ultimate or the last word, but as one part of a much larger solution, which is really all that we are saying here. We are not suggesting that labor did everything right, or management did everything wrong, or the Government is entirely at fault.

We are suggesting that to achieve the objective that you are seeking something has got to be done about trade, and nobody seems to want to do anything about it. That is what concerns us.

Senator DANFORTH. Senator Bentsen.

Senator BENTSEN. I would like to endorse that statement.

Let me say, Mr. Friedman, you said that the free market system will not take care of it. There is no free market system in automobiles. When you talk about the media, I note that some of the columnists seem almost spoonfed by the Japanese.

I can understand how popular it is to have mea culpa, and certainly American labor has been at fault in some ways, certainly American management has, but that is not the end of the story. You have to look at the faults on the other side in order to balance that equation out.

Looking at the so-called free market system, I was looking at this table for 1979, it shows on Brazil that they have less than 1 percent Japanese part imports, they require 95 percent local content, or 185 percent duty. Mexico requires a 50-percent local content. Venezuela, 51 percent local content or 120 percent duty. South Africa, 66 percent local content or 95 percent duty. Spain, 63 percent local content, and an import quota. Italy, 11 percent duty, but that is really 14 percent when you figure in the freight and the insurance the way they figure it, and then a bilateral import quota restricting Japanese imports to 2,000 cars a year. Argentina, 96 percent local content, or 95 percent duty. France, 11 percent duty, but that again works out to be about 14 percent, and a limit on Japanese cars showed at 3 percent or less. Germany, they are supposed to be an efficient outfit, 11 percent duty that works out to 14 percent with the insurance and freight. Canada, 14 percent duty. The United Kingdom, 11 percent duty and an agreement with the Japanese to restrict car market share to 10 to 11 percent or less. Australia, 85 percent local content, or 58 percent duty. The good old U.S. 3 percent duty. Where is the equity in that?

I think the Japanese are some of the toughest, most able negotiators I have ever seen, and they talk and talk, and ship and ship, and talk and talk, and ship and ship.

Mr. Chairman, perhaps that bill we had last year did a little bit of good in the bargaining. But it is obvious that in those areas where the Japanese have found that the people really mean it, and some tough things have been done, that is where the Japanese have made their capital investments, trying to step up production, and the hiring of local people; not here.

I think you are right, we have to do something. I am not quite sure what it should be, but obviously conversation and rhetoric doesn't do it, and it won't.

This is more a statement of frustration, I am afraid. But I agree very strongly with the statements made that if you don't have an automobile industry, then you don't have a steel industry, and then our country is no longer a major nation in this world.

I really have no questions, unless you want to comment on that.

Mr. FRIEDMAN. Thank you for your eloquent statement, Senator.

Mr. KOPLAN. We agree with everything you have just said, Senator.

We had mentioned, and I don't know whether I read that at the time, for example, going along with the illustrations you were giving, the French limit imports of Japanese cars to 3 percent of their market. You have mentioned the British example. The Italians have a limit that allows only 2,000 Japanese cars into Italy. We stand alone in and doing nothing. That is why they continue to flood into the United States.

Senator DANFORTH. Thank you all very much.

The next witnesses are Julian Morris, president, Automobile Parts & Accessories Association; and George Galster, vice president for International Sales, Champion Sparkplug Co., and chairman of the Automotive Parts Export Council.

Mr. Morris, would you like to begin?

STATEMENT OF JULIAN C. MORRIS, PRESIDENT, AUTOMOTIVE PARTS AND ACCESSORIES ASSOCIATION, WASHINGTON, D.C.

Mr. MORRIS. Thank you, Senator. My name is Julian Morris, and I am president of the Automotive Parts & Accessories Association [APAA] located here in Washington.

I wish to thank you for this opportunity to present our association's views about the progress of the auto components purchasing mission and related Department of Commerce activities. I have prepared a lengthy statement for your consideration, and I would be pleased to have you admit it into the record.

In summary, however, our concerns about access to the replacement parts market for Japanese vehicles in the United States as well as to the original equipment market for Japanese cars in use in Japan and third-market countries involve the very survival of the aftermarket industry as Japanese vehicles become an ever growing share of the world vehicle population.

In particular, Japanese barriers to both the replacement parts market in Japan and third markets distort international commerce, make a mockery of the principles of free trade, and endanger the ability of our vital U.S. industry to compete. Our association believes:

One. Japan has failed to comply with the goals of its orderly marketing agreement of May 1980, relating to the parts purchasing mission and certain tariff reductions.

At the time of the mission in September 1980, both Governments set a goal of $300 million in purchases by Japanese auto manufacturers this year. While APAA welcomed this target as an important first step, we could not help but note that the mammoth $1 billion parts trade deficit with Japan in 1980 makes the $300 million goal look awfully anemic.

Most regrettably, Japan reneged on its commitment to meet in Washington last August for a parts purchase review. Our association submits that the Japanese are far from their stated goal as we near the year's end, so much so that the Department of Commerce has conceded to us that Japan is reluctant or even embarrassed to give exact figures as to what the shortfall really is.

It would appear that the agreements and the institutional framework have not substantially changed things. Our producers still face a panoply of Japanese nontariff trade barriers, adding up to a general inability to penetrate the Japanese original equipment market and, of course, that means the subsequent exclusion from the worldwide Japanese aftermarket that those vehicle exports create.

Japanese tariff reductions last April 1 proved a hollow victory for U.S. manufacturers, since they have not included these labor intensive items in their $300 million target. Rather, they have focused on a selected list of OEM parts, particularly energy-intensive items, so that they preserve their own jobs, while they raid our natural resource products, glass, leather, hides are a good example, as well as precious metals for catalytic converters, and the like.

Also, the U.S. Department of Commerce must enhance its bargaining position by using every means of diplomatic leverage to press for adherence to its objectives.

It must take action at the monitoring meeting to be held in Tokyo next week to establish a bilateral understanding of the issues. In order to accomplish these ends, Commerce must be prepared to repudiate the unsubstantiated Japanese Auto Manufacturers Association [JAMA] study of the replacement parts market for Japanese vehicles in the United States. It is faulty to say the least.

Last February, our officials correctly announced with MITI that the issues at stake were the opening of the replacement parts market for Japanese vehicles in use in the United States and the original equipment and aftermarkets for Japanese cars in use in Japan. That issue was compromised, however, by other Commerce action taken at the February meeting.

Commerce embraced the JAMA report introduced by MITI, without consulting our domestic industry. If they had asked us, we could have told them that it couldn't stand as a foundation for further actions since its promising picture of the marketplace stands only as a seemingly questionable expectation like numerous other projections and estimates that fill the pages of this report.

The report flies in the face of Japan's own stated commitment in the trade facilitation process, to take steps to open their dealerships. This report disclaims those intentions, insisting that the Japanese need not do anything more.

We find the JAMA report clearly without basis and an obfuscation of the existing market relationships. We believe the Department of Commerce must take steps to repudiate it and to begin anew to define the problems. We believe this action will strengthen our negotiating position with the Japanese. The alternative is to be lulled, if not gulled, into inaction and to be deterred from a hard bargaining position on the basis of a report that denies the existence of problems we know do exist.

The Department of Commerce must address what we see as certain internal deficiencies in program development and implementation.

APAA believes that senior Commerce Department officials should immediately address weaknesses within their promotion of this major industry. We urge those at the secretarial levels to clarify the mission and set the direction for all personnel working with the parts issue.

Other important department initiatives which APAA feels are in order include greater involvement of the industry in policymaking, recruitment of industry experts and assurances of key personnel continuity and a commitment to gather comprehensive industry information.

APAA was disappointed to learn that as late as August, key personnel working with parts trade had not analyzed the JAMA report, nor was there any instruction to prepare a department critique.

APAA believes that U.S. implementation of the duty remission/local content proposal in tandem with our recommendation for a stiffening in the Commerce Department's negotiating resolve and especially its restatement of the areas of dispute, and a more competitive Commerce negotiating team will go far in moving the Japanese to keep their promise.

Again, I appreciate this opportunity to present our views and I will be happy to answer any questions that you may have.

[The prepared statement of Mr. Morris follows:]

STATEMENT OF

JULIAN C. MORRIS

PRESIDENT

OF THE

AUTOMOTIVE PARTS AND ACCESSORIES ASSOCIATION, INC.

Mr. Chairman and Members of the Subcommittee:

My name is Julian Morris, and I am President of the Automotive Parts and Accessories Association (APAA). I am pleased to have the opportunity to meet with you today and to present APAA's views about the progress of the Automobile Components Purchasing Mission and related Department of Commerce Activities.

APAA is a trade association located in Washington, D.C., comprised mainly of 1500 manufacturers, independent manufacturers' representatives, distributors, and retailers of automotive parts and accessories sold primarily, but not exclusively, in the "aftermarket." The aftermarket consists of products manufactured for and services provided to automobiles by manufacturers, distributors, and retailers that are independent of the original auto manufacturers (the "OEM market").

The aftermarket is vital to this nation's economy, providing at lease double the employment of the vehicle manufacturers and their dealers. We are hundreds of thousands of medium and large but mainly small manufacturers and others located in every state of the union producing and selling domestically in excess of $54 billion of parts, accessories and chemicals annually. Appendix A to my statement provides more details about the domestic aftermarket.

Our concerns about access to the replacement parts market for Japanese vehicles in the U.S. as well as to the original equipment market for Japanese cars in use in Japan and third market countries involve the very survival of the aftermarket industry as Japanese vehicles become an ever growing share of the world vehicle population. In particular, Japanese barriers to both the replacement parts market for their vehicles in use in the U.S. as well as the original equipment and replacement parts market in Japan and third markets distort international commerce, make a mockery of the principles of free trade and endanger the ability of our vital U.S. industry to compete. APAA believes:

(1) Japan has failed to day to comply with the stated goals of its orderly marketing agreement of May, 1980, relating to the parts purchasing mission and tariff reductions.

(2) The U.S. Department of Commerce must enhance its bargaining position by using every means of diplomatic leverage to press for adherence to its objectives. It must take action at the monitoring meeting to be held in Tokyo next week to establish a bilateral understanding of the issues. In order to accomplish these ends, Commerce must be prepared to repudiate the questionable and unsubstantiated Japanese Automobile Manufacturers Association (JAMA) commissioned study of the replacement parts market for Japanese vehicles in the U.S., which Commerce astonishingly found last February to be "useful in clarifying existing market relationships" and accepted as the basis for "seeing what other steps will be taken by the Japanese manufacturers to increase U.S. company participation in this market."

(3) The Commerce Department must address what we see as certain internal deficiencies in program development and implementation.

(4) Implementation of the APEC duty remission/local content proposal will give our industry the competitive footing it needs to meet the Japanese head-on.

Japanese Failure To Keep Commitments

The Japanese government unveiled on May 15, 1980, its program to facilitate importation of U.S.-made cars and automotive parts. Two of the three measures comprising the orderly marketing agreement bear directly on the aftermarket: (1) the promotion of auto parts imports through a government sponsored auto industry mission to the U.S., and (2) the elimination of tariffs on automotive parts effective April, 1981.

At the time of the mission in September, 1980 both governments set a goal of $300 million in purchases by Japanese automobile manufacturers and significant gains thereafter, over the U.S. released 1980 figure of $103 million. While APAA welcomed the target figure as an important step in the right direction, we agreed with then Undersecretary of Commerce for International Trade, Robert Herztein who felt a more adequate plan would be for the Japanese car makers to double their purchases of American-made parts every year for several years. The mammoth $1.1 billion parts trade deficit with Japan in 1980 indeed makes the $300 million goal look insufficient.

By the time of the first formal review of progress last February, the figures did not presage well. At this first meeting of what was supposed to become a semi-annual review over a two-year period, the Department of Commerce and MITI cautioned in their Joint Report that:

> ...both Japanese and U.S. participants must make greater efforts if purchases of automotive parts by Japanese manufacturers are to increase to the $300 million level in 1981 forecast by the Japanese participants in September, 1980 and if they are to continue to make significant gains thereafter.

Most regrettably, Japan reneged on its commitment to meet in Washington last August for another parts purchase review. Invitations were extended by Commerce for subsequent months, but the Japanese refused each time. Their one concession was to send representatives to lower level meetings, which unfortunately are not constituted to delve into the specifics of lagging parts purchases.

APAA submits that the Japanese are far from their stated goal as we near the year's end, so much so that one Commerce Department official conceded to us that the Japanese are embarrassed to submit figures for the first six months of 1981.

While the Commerce Department earlier this year assured APAA that the U.S. would not bow to a Japanese invitation for us to return to Tokyo, such a concession has now been made. Our senior officials will meet in Tokyo next week. We believe this concession does nothing to enhance the U.S. negotiating position and may well weaken it.

It would appear that the agreements and the institutional framework have not substantively changed things. Our producers still face a panoply of Japanese non-tariff trade barriers--including the withholding of Japanese parts specifications, a unwieldy parts approval system, and a uniquely strong alliance between the vehicle and parts manufacturers there. All add up to the same results--U.S. companies generally are unable to penetrate the Japanese original equipment market. This in turn excludes them from being recognized as authorized replacement parts suppliers from which dealers of Japanese vehicles around the world can confidently purchase replacement parts.

The cost for being locked out of the aftermarket for Japanese vehicles in Japan, the U.S., and third market countries has risen considerably in recent years as the worldwide car population fills with more and more Japanese vehicles, and fewer and fewer of those built in the U.S. In some countries, in fact, Japanese models account for as much as 80 percent of the vehicle mix, whereas just a few years ago, the mix strongly favored U.S.-made cars.

One key reason for why the results appear so disappointing, according to information we have from the Commerce Department, relates to the other major Japanese promise, the long overdue reduction in tariffs on automotive parts effective last April 1st. The Commerce Department analysis which I have attached as Appendix B, lists the 38 items on which tariffs were reduced to zero in one table and a separate much shorter table lists the items to be included in the $300 million "target." The lists clearly indicate that those items to be incorporated in the target do not even approach the import potential of auto parts from the U.S. nor do they include most of the items on which tariffs were lowered. In fact, there are only three items common to both tables. The tariff reductions are a hollow victory for U.S. manufacturers since Japanese auto makers do not plan to import these labor intensive items, focusing instead on energy intensive products such as glass or aluminum.

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We learn from the Department paper that:

> The explanation of this somewhat paradoxical situation appears to be that the Japanese 'commitment' for $300 million was only intended to cover OEM (original equipment manufacturer) automotive components purchased directly by Japanese auto manufacturers (Table II items), whereas total Japanese imports of auto parts from the United States include many replacement parts (Table I items or other items).

This clearly runs counter to the bilateral commitment that Japan should facilitate increased purchases for use in Japanese cars in the United States and Japan.

The Department of Commerce Must Enhance Its Negotiating Position

Our Department of Commerce must use every bit of diplomatic leverage to press for Japanese follow-through on their commitments. We believe that Commerce must act swiftly to reaffirm the issues to be negotiated. Last February, our official correctly announced with MITI that the issues at stake were the opening of the replacement parts market for Japanese vehicles in use in the U.S. and the original equipment and aftermarkets for Japanese cars in use in Japan. Although unstated in the diplomatic parlance, APAA sees additional benefits inuring from a bigger share of the Japanese original equipment market for U.S. trade performance in every third market country with Japanese cars.

Those very issues, however, are compromised by other Commerce action taken at the February meeting. MITI introduced at those proceedings a report commissioned by the Japanese Automobile Manufacturers Association (JAMA) entitled "Service Parts for Japanese Vehicles in the U.S.A." Commerce embraced the report as follows:

> USDOC found this report useful in clarifying existing market relationships and will be looking forward to seeing what other steps will be taken by the Japanese manufacturers to increase U.S. company participation in this market.

The report glows with promise for independent garages, retailers and suppliers. It notes:

> ...the replacement parts market for Japanese cars in the U.S. reached $1.06 billion in 1980. About half of this market is supplied by independent garages and retailers, i.e., suppliers not tied to Japanese manufacturers. The replacement parts market for the U.S. is expected to increase to $1.85 billion in 1985. The market share of 'independents' is expected to increase to 60 percent. Japanese firms will make further efforts to purchase more U.S. produced parts for Japanese cars in the U.S.

To the best of APAA's knowledge, Commerce never consulted the industry before signing off on this document. If they had asked our association, we could have told them that it does everything but clarify the existing market relationships and that it cannot stand as a foundation for further actions. Its promising picture of the independent market channel in the Japanese car aftermarket stands only as a seemingly unsubstantiated "expectation," like numerous other projections, estimates, and expectations that fill the pages of this report. Our comprehensive analysis of the report is attached as Appendix C. I would, however, like to address several important contradictions made in the report.

The most significant contradictions involve the need to open the Japanese car dealership and parts distribution networks in the U.S. The dubious and unsubstantiated projections for a 20 percent decline in the Japanese car dealers' network share in the aftermarket is more than double the nine percent rate of decline projected for the domestic car dealers' share. APAA questions if any one in the industry seriously expects this to happen.

The report expects the U.S. industry to accept that the relatively small share now held by the independent aftermarket is due both to the relatively small share held by Japanese vehicles in the total vehicle mix and to the relatively young age of those vehicles. Yet, by the report's account, 21.3 percent of all new 1980 vehicles registered in the U.S. are Japanese made. Furthermore, when forecasting the future share of the total vehicle population to be held by the Japanese, the report counts trucks twice and erroneously projects a 10.9 percent share of the total U.S. car park in 1985, when the actual figure should be 11.3 percent, a most significant discrepancy when discussing millions of vehicles.

As for the age argument and others in the report, one must extrapolate from the chart and its application to find the truth. Contrary to the argument that Japanese cars in the U.S. are young, APAA has calculated from the report that 68 percent of Toyotas and 66 percent of Datsuns account for nearly 30 percent of the entire import car park over two years old. Indeed, there is already significant maturity in their fleet. Since the report contends that market problems will be rectified when the cars mature, this contradiction is important.

The report flies in the face of Japan's own stated commitment in the trade facilitation process--to take steps to open their dealerships. This report thwarts those intentions, insisting that the Japanese need not do anything more. If, as the report's introduction states, this information presages "the direction that we (JAMA) feel should be taken to result in increased participation by U.S. manufacturers in the U.S. replacement parts market for Japanese vehicles," APAA believes no significant improvement is in store.

On the related matter of U.S.-made automotive products handled by Japanese car distributors, JAMA claims:

> ...that each Japanese automaker has continued to adopt U.S.-made automotive products for the U.S. market as produced by the U.S. automotive manufacturers to the greatest degree possible with full efforts to promote and sell such products through their Japanese car dealers in the U.S.

Nowhere, however, is evidence offered for these magnanimous assurances. While offering no explanation, the report at this point begins to compare Japanese "replacement parts" exported to the U.S. with U.S.-made "automotive products." This significant change in the terminology warrants an explanation, but none is made.

While reporting that 86.3 percent of U.S. warehouse distributors handle import parts and 94.6 percent of warehouse distributors procure parts for import cars, no breakdown is offered for Japanese imports in either instance, which may indeed account for the telling bottom line that only five to ten percent of U.S. warehouse distributors had a full line of Japanese items and the vast majority had extremely limited lines. While conceding that the "current situation with overseas affiliate companies or by importing is sufficient," the report presents two specious reasons, the small number of Units In Operation (UIO) and the rather young age of the U.I.O.

There will of course never by any meaningful participation in the aftermarket for Japanese vehicles in the U.S. without more open dealerships and meaningful access to the Japanese O.E. market. APAA can assure you despite all JAMA's words to the contrary that our industry suffers from apparent monopolistic dealership practices and nontariff barriers to Japanese markets. APAA testified in June, 1980 before the Senate Small Business Committee on apparent requirements whereby Japanese auto makers compel their franchised dealers to sell only parts manufactured by Japanese original equipment manufacturers, thereby effectively prohibiting competition from U.S. parts suppliers. The Senate has called for an FTC investigation of this practice on the basis of that testimony. APAA also related the experiences of several APAA member companies to demonstrate the strategies used by Japanese distributors to keep American products from penetrating the Japanese market.

Since we find the JAMA report clearly without basis and an obfuscation of the existing market relationships, we believe that Commerce must take steps to repudiate it and to begin anew to define the problems. We believe this action will enhance our negotiating position with the Japanese. The alternative is to be lulled into inaction and to be deterred from a hard bargaining position on the basis of a report that denies the existence of problems we know to exist.

Part of the strong position, again, means holding the Japanese to every commitment they make, including release of data and times and places of meetings. It also summons Commerce initiative to gather industrywide data to buttress our basic premises.

The Commerce Department Must Address Internal Deficiencies

APAA believes that senior Commerce Department officials should immediately address weaknesses within their promotion of this major industry. We urge those at the secretarial levels to clarify the mission and set the direction for all personnel working with the parts issues. Other important department initiatives which APAA feels are in order include greater involvement of the industry in policy making, recruitment of industry experts and assurances of key personnel continuity and a commitment to gather comprehensive industry information.

APAA experiences tied to the JAMA report demonstrate problems in these areas. As far back as the report's introduction last February, Commerce did not consult the industry before accepting it. APAA did not learn of the report until reading of it in the Joint Report, and our request for a copy last May was denied on the basis that JAMA had deemed it confidential. Although the Joint Report promised that "JAMA will distribute the contents of the report to U.S. importers and distributors and others concerned," a second report issued subsequently by another Commerce office working with parts trade made no such promise.

While the Joint Report proved ultimately to be the definitive word and APAA prevailed in receiving a copy, it was dismaying to learn of the lack of inter-office coordination and the general unfamiliarity with either report by key department staff. APAA believes there is a great deal of overlap in parts trade responsibilities and that Commerce should move towards a more unified approach to this vital industry. The struggle in obtaining the report was unnecessary and reflects a lack of direction and sense of mission. Personnel working with parts issues should recognize that their mission is to promote U.S. parts sales both here and abroad.

Appropriate direction includes recruiting experts and assuring some continuity in their liaison with industry, and a key facet of the department mission should be critical analysis of industry data, drawing on industry assistance. Too often APAA has been told that those assigned to the parts sector do not know the industry. APAA was disappointed to learn that as late as August, key personnel working with parts trade has not analyzed the JAMA report, nor was there any department instruction to prepare a department critique.

The lack of continuity posed obstacles to APAA's offer to assist Commerce in critiquing the study. Since May, APAA has heard different stories from three officials moved about in the department. First, an official invited an APAA criticism of the report so that it could be placed on the August monitoring meeting agenda. However, his responsibilities shifted and we were next told there would be no department critique of the report at the meeting. Recently, after another personnel change, Commerce indicated that APAA's comments may be employed if there is a need to refute MITI at the December meeting. APAA believes responsible officials should direct negotiators to stand prepared to repudiate JAMA's analysis.

The administration's trade policy statement released last July tells of efforts to improve the quality of commercial attaches. While APAA welcomes this change, we think a stronger recruitment effort is the key to placing knowledgeable people in the parts sector. These experts would be sure of themselves when meeting with the Japanese at the bargaining table.

APAA feels that some of the most crucial competition at stake is between the governments. MITI's submission of the JAMA report at the same time it was agreeing to the basic areas of dispute indicates our personnel face stiff competition. Improvements along the above lines will assure our industry that it has a tough negotiating team representing its interests.

APAA Supports APEC's Duty Remission/Local Content Plan

APAA fully endorses the Automotive Products Export Council (APEC) plan for implementing duty remission/local content along the lines of Canada's program. The plan would provide incentives for a 14 percent duty which could be rebated to the manufacturing company in an amount corresponding to the value of American local content installed on vehicles exported anywhere in the world. The U.S. already employs the basic concept, a duty with rebates, but the 2.5 percent duty offers little incentive for the Japanese to use it. Adoption of the program would place us on a par with Canada, which has experienced tremendous success since its implementation in 1978. The duty level would bring us more into line with other industrialized nations.

APAA believes that Canadian experience with the plan has been good across the board--not only do they now export more parts to Japan than does the U.S., but the cost of vehicles to consumers has not spiralled. APAA endorses it as the efficient and equitable solution. It would foster U.S. efficiency and competition because only the firms offering Japan the best quality and price would have their parts used by Japanese parts manufacturers. Further, it would lend itself to a more efficient resource allocation, no longer giving the Japanese a free ride to import only our energy intensive products. The equity comes from assuring the U.S. an equal footing in competing with Japanese firms that were fashioned under what Secretary Baldrige has described as the practice of (1) protecting their industry from infancy through a strong growth period, (2) making them strong with subsidies, and (3) then turning them loose on the world and calling it free trade. APAA feels that the APEC plan would foster free and equitable trade. It would also dispel notions of establishing Japanese parts production facilities in the U.S. at a time of excess domestic capacity.

Conclusion

APAA believes that U.S. implementation of the duty remission/local content proposal in tandem with our recommendations for a stiffening in the Commerce Department's negotiating resolve and especially its restatement of the areas of dispute, and a more competitive Commerce negotiating team will go far in moving the Japanese to keep their promises, which we clearly have shown they are not now doing.

In the event that the Japanese do not wish to cooperate in the near future, we will at least have prepared our industry to cope with the challenge. The key here is to take preventive measures, or we face the continued decline of a leading industry.

Again, I appreciate this opportunity to present our views and I will be happy to answer any questions that you may have.

APPENDIX A

SIZE OF THE AUTOMOTIVE AFTERMARKET

RETAIL SALES DOLLARS[1]

Size of the Automotive Aftermarket in 1979 (in billions of 1979 retail dollars).

Replacement parts	
Batteries	2.59
Brakes	
Drums & Rotors	.19
Friction Materials	.87
Brake Hardware	.07
Hydraulic Parts	.47
Chassis	
Exhaust System	1.70
Shocks	.77
Steering and Suspension	.51
Drive Train	
Axles	.64
Transmissions	.99
Joints	.37
Clutch	1.08
Electrical	
Wire and Cable	.64
Parts	2.84
Filters	
Air	.59
Oil	1.08
Other	.34
Spark Plugs	.97
Replacement glass	.71
Other Replacement Parts*	19.96
Chemicals	
Functional Fluids	1.03
Maintenance Chemicals	.63
Appearance Products	.50
Tires	11.60
Motor Oil	2.75
TOTAL	$53.89

*Includes engines and engine accessories, miscellaneous crash parts, lamps, radios, accessories and air conditioning.

NUMBER OF FIRMS

	(Establishments)
VEHICLE PARTS AND MANUFACTURING[2]	
Motor Vehicle Parts and Accessories	2,610
Truck Trailers	351
Automotive Stampings	579
	3,540
WHOLESALING	
Automotive Parts Wholesaling[3]	28,750
Motor Vehicles, Tires & Tubes[4]	10,164
	38,914
REPRESENTATIVES	
Total Representatives[5]	3,000

RETAIL OUTLETS[6]

AUTOMOTIVE RELATED	
Service Stations	150,100
Tire Stores	14,800
Other Auto Supply	28,600
Other Automotive	27,100
AUTO SPECIALTY REPAIR	12,800
OTHER AUTO REPAIR	97.900
OTHER AUTOMOTIVE OUTLETS	
Discount Stores	6,900
Department Stores	2,700
Grocery Stores	83,600
Drug Stores	13,400
Variety Stores	5,900
Hardware Stores	17,800
Other Outlets	28,500
TOTAL RETAIL OUTLETS	471,100

EMPLOYMENT[7]

VEHICLE & PARTS MANUFACTURING	1,643,000
VEHICLE SALES & MAINTENANCE	
Wholesaling	423,175
Retailing	1,710,832
Selected Services	483,191
Highway Construction Maintenance	803,699
Related Industry (Petroleum)	281,625
LOCAL TRANSPORTATION & TRUCKING	9,381,777
TOTAL EMPLOYMENT	14,729,299

SOURCES

1. Automotive Market Research Council
2. Motor Vehicle Manufacturers Association
3. Automotive Service Industry Association
4. U.S.Bureau of the Census and The American Trucking Association
5. Automotive Chain Store Magazine
6. Automotive Parts & Accessories Association
7. U.S.Bureau of the Census

U.S.-JAPAN AUTO PARTS TRADE APPENDIX B

In May 1980 the Japanese government presented to the United States a statement of an understanding between the two countries concerning a broad range of automobile issues. As part of this statement, Japan agreed to eliminate, in principle, tariffs on auto parts and to support an auto parts buying mission.

Effective April 1, 1981, tariffs were in fact eliminated on 38 automotive parts categories* and reduced for one other category(tires). With the major exception of carpeting(BTN 58.02)--for which an "ex-out" for motor vehicles was deemed impractical--the Japanese tariff reductions were almost fully responsive to U.S. requests(items identified as of greatest interest to the United States).

One result of the auto parts buying mission of September 1980 was that in February 1981 the Japanese government indicated that automotive component purchases by Japanese auto manufacturers from U.S. suppliers were expected to increase to $300 million in 1981.**

Table I(attached) indicates the automotive parts categories on which Japan reduced tariffs as of April 1, Japan's 1980 imports in these categories from the United States, the "corresponding"*** U.S. export categories, and the United States' 1980 exports to Japan in these categories.

Table II(attached) indicates the automotive parts categories which represent purchases by Japanese auto manufacturers to be included in the $300 million "target", Japan's 1980 imports in these categories from the United States(about $152 million), the "corresponding" U.S. export categories, and the United States' 1980 exports to Japan in these categories.

It is clear from an examination of these two tables that the list of items to be included in the $300 million "target" does not represent total Japanese imports of auto parts from the United States nor does it include most of the items on which tariff reductions occurred.****

The explanation of this somewhat paradoxical situation appears to be that the Japanese "commitment" for $300 million was only intended to cover OEM(original equipment manufacture) automotive components purchased directly by Japanese auto manufacturers(Table II items), whereas total Japanese imports of auto parts from the United States include many replacement parts(Table I items or other items).

* on a 7-digit BTN basis; there were 22 tariff categories
** see "Joint Report of the First Monitoring Meeting of the Automobile Components Purchasing Mission," February 6, 1981
*** items and trade values "correspond" only in a very rough sense due to differences in definitions of Japanese import categories by BTN nos. and U.S. export categories by schedule B nos. and other factors
**** three items common to both tables are BTN 40.11-111, 85.09-120, and 87.06-299

Prepared by: D. Businger USDOC/ITA/IEP/TA/OISP 6/26/81 (202)-377-4466

TABLE I -- U.S.-JAPAN AUTO PARTS TRADE, 1980
ITEMS INVOLVED IN JAPANESE TARIFF CUTS
OF APRIL 1, 1981

Japanese Imports from U.S.			U.S. Exports to Japan		
BTN No.	Product Description	CIF Value * (¥ mill.)	Sch. B No.	Product Description	FAS Value * ($ 000)
40.11 - 111	Pneumatic tires and tire cases (new) for passenger cars	1,614	772.5105	Passenger car tires, pneumatic, new, except recapped	5,536
70.09 - 000ex	Glass mirrors, for motor vehicles	100	544.5020	Glass mirrors for automotive use	42
73.35 - 100	Chassis springs and leaves for motor vehicles	15	652.8120	Chassis springs and leaves for motor vehicles	32
83.02 - 210	Base metal fittings and mountings for motor vehicles	228	647.0420	Automotive hinges and butts of base metal	30
			647.0440	Automotive hardware of base metal	610
84.06 - 113	Gasoline engines for motor vehicles	82	660.4830	Gasoline engines for motor vehicles	112
- 119	Diesel engines for motor vehicles	1,003	660.4110	Diesel engines for motor vehicles	357
- 221	Pistons and rings for motor vehicle engines	387	660.5210	Parts,nspf,of gasoline engines for motor vehicles	12,654
- 229	Parts for motor vehicle engines, nes	1,351	660.5410	Parts,nspf,of diesel engines for motor vehicles	6,050
84.12 - 110	Air conditioners for motor vehicles	183	661.2210	Air conditioners for motor vehicles, and parts thereof	3,126
- 120	Parts of air conditioners for motor vehicles	56			
84.18 - 210ex	Filtering and purifying machinery for liquids or gases, for motor vehicles	4,590	660.5210	As above	as above
			660.5410	As above	as above
- 220ex	Parts of filtering and purifying machinery for liquids or gases, for motor vehicles	4,209	692.2985	Parts,nspf, of motor vehicles for the transport of persons or articles	33,678

* N.B.: For those categories where the trade data includes non-automotive items (all Japanese items with an "ex" and several schedule B categories among the U.S. items) the value indicated obviously overstates the amount of automotive trade. Hence, the totals at the end of the table are likewise significantly overstated as an indication of the amount of "auto parts" trade in these categories.

U.S.-JAPAN AUTO PARTS TRADE(1980)
(TABLE I cont'd)

Japanese Imports from U.S.			U.S. Exports to Japan		
BTN No.	Product Description	CIF Value (¥ mill.)	Sch. B No.	Product Description	FAS Value ($ 000)
84.63 - 210ex	Crankshafts and parts thereof, for motor vehicles	182	660.5210	as above	as above
			660.5410	as above	as above
- 220ex	Cam shafts and parts thereof, for motor vehicles	1,349	692.2985	as above	as above
			680.9212	Rod ends, mounted	89
- 230ex	Bearing housings and parts thereof, for motor vehicles	1,073	680.9215	Plain bearings,mounted,exc rod ends	as 356
			680.9220	Plain bearings(bushings),unmounted	976
- 240ex	Flywheels, pulleys, pulley blocks and parts thereof, for motor vehicles	355			
84.64 - 000ex	Gaskets, for motor vehicles	394	773.2520	Gaskets of rubber or plastics for automobile, aircraft and other vehicles	117
85.08 - 110ex	Dynamos and electric starter motors, for motor vehicles	452	683.6040	Starter(cranking) motors for internal combustion engines	105
- 120ex	Parts of dynamos and electric starter motors, for motor vehicles	113	683.6020	Battery charging generators for internal combustion engines	141
- 210	Spark plugs and glow plugs for motor vehicles	330	683.6060	Spark plugs for internal combustion engines	1,149
- 311	Distributors and ignition coils for motor vehicles	36	683.6075	Distributors for internal combustion engines	11
			683.6045	Ignition coils for internal combustion engines	145
- 391	Other electrical starting and ignition equipment for internal combustion engines	133	683.6065	Distributor contact(breaker) point sets for internal combustion engines	0
			683.6080	Electrical equipment,nspf, and parts, nspf, for internal combustion engines	761
			688.1200	Ignition wiring sets and wiring sets for use in motor vehicles	554
85.09 - 110	Electric horns for motor vehicles	29	685.7085	Motor vehicle signaling equipment,nspf, including horns and parts thereof,nspf	417
- 120	Electrical lighting and signaling equipment and other electrical equipment(wipers, defrosters,etc.) for motor vehicles	900	683.6500	Electrical lighting equipment, except signal lights, for motor vehicles and parts thereof,nspf	350
			692.2985	As above	as above

U.S.-JAPAN AUTO PARTS TRADE(1980
(TABLE I cont'd)

Japanese Imports from U.S.			U.S. Exports to Japan		
BTN No.	Product Description	CIF Value (¥ mill.)	Sch. B No.	Product Description	FAS Value ($ 000)
85.09 - 130 (cont'd)	Parts of electrical lighting and signaling equipment and other electrical equipment (wipers, defrosters, etc.) for motor vehicles	132	685.7080	Motor vehicle signal lights and parts thereof,nspf	35
85.15 - 111	Radio broadcast receivers(incl. chassis), incorporating sound recorders or reproducers, designed or adapted for fitting to motor vehicles	4	685.2610	Radio receivers, AM and AM/FM, designed for motor vehicle installation	770
			685.5385	Radio phonograph, tape recorder, etc. combination, except television	272
- 112	Radio broadcast receivers(incl. chassis), designed or adapted for fitting to motor vehicles,nes	4			
87.04 - 000	Chassis fitted with engines for certain motor vehicles	6	692.2080	Chassis, motor bus	0
			692.2090	Chassis, truck and truck tractor	931
			692.2260	Chassis, passenger automobile	40
			692.2280	Chassis, motor vehicle,nspf	143
87.05 - 090	Bodies(incl. cabs) for certain motor vehicles,nes	39	692.2010	Bodies(incl. cabs) for trucks	33
			692.2020	Bodies(incl. cabs) for truck tractors	0
			692.2030	Bodies, motor bus	9
			692.2215	Bodies, passenger automobile	9
			692.2240	Bodies, motor vehicle,nspf	15
87.06 - 190	Chassis for certain motor vehicles, nes	2	692.2080,2090,2260,2280	as above	as above
- 291	Clutch discs for motor vehicles, nes	115	692.2930	Clutch facings and linings, motor vehicle, asbestos	610
- 292	Shock absorbers for motor vehicles, nes	334	692.2944	Shock absorbers for motor vehicles	617

U.S.-JAPAN AUTO PARTS TRAD 1980)
(TABLE I cont'd)

	Japanese Imports from U.S.			U.S. Exports to Japan	
BTN No.	Product Description	CIF Value (¥ mill.)	Sch. B No.	Product Description	FAS Value ($ 000)
87.06 - 299 (cont'd)	Other parts and accessories of certain motor vehicles, nes(incl. variable speed transmissions and parts; clutches and parts)	8,489	692.2904	Body stampings, motor vehicle	284
			692.2908	Bumpers, motor vehicle	83
			692.2912	Motor vehicle wheels, to be mounted with pneumatic tires	962
			692.2916	Hubcaps and wheel covers, motor vehicle	71
			692.2920	Radiators, motor vehicle	77
			692.2924	Mufflers and tailpipes, motor vehicle	108
			692.2926	Brake linings and disc brake pads, motor vehicle, asbestos	647
			692.2928	Motor vehicle brakes and parts,nspf	4,545
			692.2932	Transmissions for automobile trucks, truck tractors, and motor buses	13,393
			692.2936	Transmissions for passenger automobiles	3,635
			692.2940	Motor vehicle transmissions,nspf	927
			692.2985	As above	as above
90.27 - 010ex	Tachometers(nonelectrical), for motor vehicles	29	711.9225	Revolution, production counters, taxi-meters, etc., nonelectrical	353
- 090ex	Speed indicators, stroboscopes, etc. (nonelectrical), for motor vehicles	252	711.9235	Speed indicators, tachometers, stroboscopes, nonelectrical	42
90.28 - 215ex	Automatic controlling apparatus (electronic), for motor vehicles	2,854	711.9220	Revolution, production counters, taxi-meters,etc., electrical	243
- 223ex	Tachometers and speedometers (electronic), for motor vehicles	235	711.9230	Speedometers and tachometers, stroboscopes, electrical	132
- 236ex	Automatic controlling apparatus (electrical), for motor vehicles,nes	93	711.8050	Flow or liquid level controlling inst, exc ind process, electrical	1,277
- 244ex	Tachometers and speedometers (electrical), for motor vehicles, nes	34	711.8080	Liquid or gas variable control inst, electrical, exc ind process	4,898
Total Japanese Imports from U.S. of above items		31,786	Total U.S. Exports to Japan of above items		102,559
at exchange rate of 227 ¥/$		$140 mill.		or about	$103 mill.

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TABLE I -- U.S.-JAPAN AUTO PARTS TRADE 1980
ITEMS PURCHASED BY JAPANESE AUTO MANUFACTURERS

	Japanese Imports from U.S.			U.S. Exports to Japan	
BTN No.	Product	CIF Value* (¥ mill.)	Sch. B No.	Product	FAS Value* ($000)
38.19 - 510 - 530	Catalysts	17,792(34,685)	433.1035	Compound catalysts, nspf	45,447
40.11 - 111 - 190	Tires	106(1,725)	772.5105	Passenger car tires	5,536
41.02 - 212 - 231 - 239	Cattle leather	713(989)	121.0220	Upholstery leather	2,145
56.07 - 122 - 146 - 158	Seat fabrics	840(1,401)	338.2960 338.2965 338.2985	Polyester spun fabrics	5,004
59.08 - 000			various for	Coated fabrics	
58.02 - 231	Carpeting(of man-made fibers, tufted)	1,199(3,030)	360.8040 360.8060	Floor coverings, tufted, of cellulose or non-cellulose fibers	6,479
70.08 - 020	Laminated glass	250(318)	544.4120	Laminated glass, automotive	1,091
84.11 - 390 - 430	Turbochargers and parts	4,499(4,956)	660.5210 660.5410	Parts, nspf, of gasoline & diesel engines for motor vehicles	18,704
85.09 - 120	Lamps	454(900)	683.6500	Electrical lighting eqpt, exc signal lights, for motor vehicles and parts thereof	350
87.06 - 299	Catalytic converters	150(8,489)	692.2932 692.2936	Transmissions for motor vehicles	17,028
- 299	Transmissions	3,290			
- 299	Other	incl. infra	692.2985 and other**	Parts, nspf, of motor vehicles	33,678

U.S.-JAPAN AUTO PARTS TRADE, 1980
(TABLE II cont'd)

	Japanese Imports from U.S.			U.S. Exports to Japan	
BTN No.	Product	CIF Value* (¥ mill.)	Sch. B No.	Product	FAS Value* ($000)
Other(68.14,85.04,85.08,87.06) incl. friction material, batteries, plugs		4,122(26,391)	692.2926,683.1020,683.6060, & other incl. brake linings, batteries, plugs		2,472
Total Japanese Imports from U.S. of above		33,415(82,884)	Total U.S. Exports to Japan of above		137,934
at exch rates of 220 & 227 ¥/$, resp.		$152 mill($365 mill.)		or about	$138 mill

* first yen figure represents import purchases for motor vehicle use by Japanese auto manufacturers as reported directly to MITI; second yen figure represents total imports, as U.S. figure total exports. Latter two are thus significantly inflated by non-motor vehicle items

** this sch. B no. includes catalytic converters and many other parts and accessories that correspond to BTN 87.06 - 299; other schedule B nos. may correspond to the "other" portion of the Japanese imports but the trade covered was not included since the amount of U.S. exports under this sch. B no.($33 mill.) substantially exceeds the Japanese imports of "catalytic converters" and "other" combined(the "other" being included in the 4.1 mill. yen below which also includes friction material, batteries and plugs)

APPENDIX C

CHAPTER I. JAPANESE VEHICLE REPLACEMENT PARTS MARKET IN THE U.S.

Section 1. Japanese Vehicle Population in the U.S. -- present & future

A. New Vehicle Registrations (Exhibit 1-1)

Page 3, Line 2 Cites Exhibit 1-1, sources: Automotive News and JAMA. Shows growth in Japan's market share of new cars from 16.8% of new cars in 1979 to 21.3% in 1980. As JAMA notes, this 21.3% share of the new car market sets a record level.

Comment: The report should not include VW and other imports. They do not pertain to the report's stated intention "to conduct research to define the actual state of the parts after-market for Japanese-made cars in the U.S." (Page 2, Line 9-10)

Line 5-8 Notes that the 20% decline in domestic sales "can be considered to account for the overall rise in the share of Japanese vehicles."

Comment: No explanation or evidence is given to substantiate such a cause-effect relationship.

Furthermore, although mentioning the relationship of the sharp Japanese increase to the precipitous U.S. decline, no mention is made that VW declined 27% and "other imports" were down 8%.

No breakdown is made for "other imports" totaling 390,795 units.

B. Vehicle Population (U.I.O. - units in operation) (Exhibit 1-2, 1-3)

Line 10 Cites Exhibit 1-2. The pie chart shows three Japanese auto makers holding a joint total share of the import vehicle population of 40%. A significant 37.3% share is held by unnamed "other" imports. VW holds a 22.7% share.

Comment: Exhibit 1-2 proves very unsatisfactory for purposes of the Japanese vehicle discussion.

VW's 22.7% share appears in order to make the three Japanese auto makers' share look smaller.

Lines 11-12 Cites estimates that total U.S. car park in 1980 stood at 142 million units, including 11 million Japanese units (8.1% share).

Lines 13-14 Notes "projecting 5 years ahead," total car park should grow to 163 million units (a 21 million unit increase), with 18 million Japanese units (10.9% share).

Comment: No specific source is given for who is "projecting" the 1985 Japanese share or for the 1980 estimates cited.

Lines 16-17 The report laments that "when compared to the registration of new vehicles, the share of Japanese vehicles (10.9%) in the total U.S. vehicle population is still at a low level."

Comment: These figures in no way portray the depth of the Japanese market penetration. If indeed, one accepts a growth of 21 million units by 1985, and 7 million units (one-third) of that growth is attributed to Japanese vehicles, one begins to sense the scope of market trends. These figures illustrate visions of much higher market shares than the record 21.3% share held in 1980.

Exhibit 1-3, offered to support the above, has no specific source attributed to it. It shows the share of other imports slipping between 1980 and 1985, from 4.7 million units in operation to 2.1 million units, a decline of 55.3%, while Japan will increase its units from 11.4 million to 17.8 million.

Comment: This is interesting in light of the previous use of VW and "other" imports to make Japanese shares of total imports look smaller.

Exhibit 1-3 also dramatically understates the Japanese share of units in operation in 1985.

In accompanying charts, trucks are counted twice to make the grand total of vehicles in operation larger. For 1985, the chart breaks down Japanese vehicles into 12 million cars and 5.8 million trucks. The figure for imports actually counts the 5.8 million trucks in the total for cars. Thus, when U.S. domestic cars of 100.8 million and the 19.9 million imports are added, total cars is 120.7 million. Then, when counting trucks, the same 5.8 million Japanese trucks are added to 36.2 million U.S. domestic trucks, for a total of 42 million trucks. Therefore, the grand total of cars and trucks is overstated by 5.8 million units, and should actually be 156.9 million. Using this smaller total, the share of Japanese vehicles in 1985 rises from the stated 10.9% to .

11.3%, a very significant increase. The figures for 1980 are also overstated, and the actual Japanese vehicle share should be 8.24% instead of 8.1%.

Lines 18-19 Report a "review of the top four imports (VW, Toyota, Datsun, and Honda) shows they account for 63% of total U.S. imports."

Comment: The only pertinent information should be the 40% share held by the three top Japanese auto makers, and the breakdown of the 37.3% "other" to show Japanese vehicles.

C. Change in Vehicle Age (Exhibit 1-4, 1-5)

Lines 21-22 States "the age of the vehicle population is a key factor in determining the size and structure of the total replacement parts market."

Lines 22-25 Compares the average age level of "VW at 8 years" with the relatively younger U.I.O., of Toyota and Datsun at 5 and the Honda at 3 years."

Comment: Report once again clouds the issue by including VW in the analysis.

Lines 25-26 The above claims to show "that the replacement parts market for Japanese vehicles has not yet matured."

Comment: No explanation offered as to how this is shown.

Lines 27-28 Contends: "In terms of the age of U.I.O., vehicles over 2 years old are the most influential in creating parts demand."

Comment: If one accepts this, there should already exist strong parts demand due to significant numbers of Japanese vehicles averaging 5.2 years in age.

Lines 28-29 Cites "figures for Japanese U.I.O. in 1980, 75 million units (65.8%) are over two years old."

Comment: This text and its supporting Exhibit 1-4 leave the most pertinent information unstated. Unmentioned is that 68% of Toyotas, 66% of Datsuns, and 56% of Hondas are over two years old. So many vehicles are well over two years old that their respective average ages are: Toyota (5.2) Datsun (5) and Honda (3).

Exhibit 1-4 breaks down the various makes of imports to show the weighted share each has in the total import park over two years old.

Comment: The text nowhere notes that of the total import car park over two years old, 29.8% are Toyotas and Datsuns. This means that 68% of Toyotas and 66% of Datsuns account for nearly 30% of the entire import car park over two years old. Indeed, there is already significant maturity.

Exhibit 1-4 cites "others", but gives no breakdown. In this case, 38.3% are labeled "others." Of the total 5,989,000 "others", nearly 75% fall in the over two years old category, and the average age for these vehicles is 6.2 years. Left unstated is how many of these are older Japanese units.

Lines 29-32 Envisions in 1985 "13.7 million units (77%) of the projected Japanese U.I.O. will be two years old or older. This is an 83% increase."

Comment: This glowing picture of the future is held out as if there were no significant maturity already. No mention is made of how the 1985 projections will change things materially.

As for the "83% increase", it is a rather dubious use of figures. The rate of change which is of concern is the 11.2% in percentage of units 2 years or older. This real percentage change is 17%, far different than an 83% increase. And, when looking at it from the perspective of absolute shares in a market, it is an absolute percentage change of 11.2%, from 65.8% to 77%.

Never attributes information to a specific source but lists JAMA and their contractor, Management Perspective as two of the three sources.

Section 2. Replacement Parts Market for Japanese Vehicles in the U.S.- present & future

A. Replacement Parts Market Size in the U.S. (Exhibit 1-6)

1. Present - 1980

Page 4, Line 1 Bases discussion on Exhibit 1-6. After showing in other exhibits a declining share for other imports, this exhibit shows an increase for the replacement parts market for both imports and Japanese vehicles. The size of the replacement parts market for Japanese vehicles is seen growing from $1.06 b. in 1980 to $1.80 b. in 1985. The total figure for Imports is seen climbing from $2.56 b. in 1980 to $3.31 b. in 1985.

The pie charts and accompanying table show a replacement parts market for Japanese vehicles in 1980 of $1.06 b. (3.1% of the total market). Of this amount, the dealers' share is $0.53 b. (1.6% of the total market). The total Japanese market and dealers' shares are to grow respectively to $1.80 b. (4.3% of total market) and $0.72 b. (1.7% of total market), in 1985.

Comment: One is to believe that of the $0.74 b. in projected growth, only $0.19 b. of the increase will be attributed to the dealers (growing from $0.53 b. to $0.72 b. So, while they now have a 50% share in 1980, by 1985, their share is expected to decline to 40%.

The table shows the "imports" replacement market growing from $2.56 b. in 1980 to $3.31 b. in 1985, a change of $0.75 b. If this is to be believed, then of the total import increase of $0.75 b. , Japanese vehicles will account for $0.74 b. of it, or all but $0.01 b. (for other imports). What imports are included here? All imports as before? The figures are very suspect.

Lines 3-4 "It is expected" that the total 1980 market for replacement parts will amount to "$34.6 b. on a retail basis."

Comment: The report fails to note who specifically "expects" this.

The report also fails to credit specific sources for the projections in Exhibit 1-6, even though JAMA and its contractor, Management Perspective are two of three sources cited.

Lines 5-6 "In this total, the replacement parts market for Japanese vehicles is estimated at $1.06 b."

Comment: Again, there is no firm source cited for this estimate; no study cited to show it.

Lines 7-8 "As this constitutes a 3.1% share of the total replacement parts market, it can be said that the market for Japanese vehicle replacement parts is still small."

Comment: By whom can this be said? After all, the Japanese are supplying replacement parts for their cars. The issue is how much of the business U.S. firms have, and that can truly be said to be small.

2. Future - 1985

Lines 10-11 "The total replacement parts market is projected to expand 20% over the next five years to reach a value of $41.5 b. (retail)."

Comment: Again, there is no specific substantiation for these figures. There is no explanation, either, for why in this period of expansion (20%) would all other imports gain only $0.01 b. of the total $0.75 b. gain for imports.

Lines 12-13 "The replacement parts market for Japanese vehicles is projected to amount to $1.8 billion in 1985."

Comment: Again, no adequate source is provided for the projection.

Lines 14-16 Claims a projected Japanese "expansion of approximately 70% in five years and represents a market share increase of 1.2 percentage points from 1980 to reach 4.3% of the total replacement parts market which is still a comparatively small ratio."

Comment: No substantiation is advanced for the projected expansion.

There is no mention of the implications for other imports.

The lament that they will still have "a comparatively small ratio" in no way detracts from the tremendous projected increase in sales.

Lines 17-18 Claims the Japanese dealers' share will be "only 1.7% of the total replacement parts market in the U.S.", a decline in its percentage share.

Comment: No study is advanced to prove the projected dealer decline at a time of such large increases.

B. Replacement Parts Market Size and Share by Sales Channel -- present & future (Exhibit 1-7, 1-8)

1. Present - 1980

Lines 23-26 "Of this total ($1.06 billion, 1980) it is estimated that Japanese dealers have a market share of 50-55% (A.T. Kearney)."

Comment: While citing JAMA's contractor, Kearney, no study is cited for Kearney's findings. This same deficiency applies to the other figure of "45-50% or $530 million of the replacement parts market sold through independent repair shops and other retail distribution outlets outside the car dealer channel."

Lines 27-28 "In general, U.S. domestic car dealers account for 18% of the total parts sales for U.S. domestic makers in comparison with the already mentioned 50-55% share of Japanese car dealers."

Comment: What is meant by "in general"? Who is the actual source for this information, and what basis? Specific information is needed.

Lines 29-31 The two factors cited for this difference are "the low level of Japanese vehicles in the total U.S. vehicle population and that the age of the Japanese U.I.O. is still relatively young."

Comment: Using the Japanese standards, a vast number of their vehicles in our car park are not young making for very specious reasoning.

2. Future - 1985

Page 5, Lines 2-5 Notes that in the U.S. market, "car dealer share of total parts sales have historically and continually declined" from a 95% share held by U.S. car dealers in 1920 to "only 18%" in 1980.

Comment: If one accepts the figures for the declining car dealer share of total parts sales for domestic makers, one must note that of the 77% reported decline from 95% in 1920 to 18% in 1980, 65 of those percentage points of decline occurred before 1960. Or put another way, 85% of the total decline portrayed had occurred by 1960.

The next increment of decline from 30% in 1960 to 21% in 1972 represents 9% of the 77% decline, or about 11% of the total decline. The increment from 21% in 1972 to 18% in 1980, or three of the percentage points of decline represents 3.9% of the total decline.

Looking only at the last eight years experience, there has been a decline from 21% to 18%, or about 15%. And, from 1980 to 1985, about an 11% decline. Indeed, the rate of decline has been slowing significantly since 1960.

Lines 4-5 "This historical trend shows that Japanese car dealers will not be an exception."

Comment: Yet, their own figures show a decline from 50% in 1980 to 40% in 1985, a 20% rate of decline, more than double the 9% decline projected for the U.S., from 18% to 16%. Who really expects this to happen?

Lines 8-9 Repeats the claim that the Japanese dealers' share in the replacement parts market is "expected to decline."

Comment: While there may be a decline, it will be most unlikely to see the projected magnitude.

Lines 10-13 Claims: "And, this declining trend will be further exacerbated by the increased activity and participation of U.S. parts manufacturers and the independent distribution channel in the Japanese replacement parts market as well as increasing inflation and the change in consumer purchase patterns to D.I.Y. as a consequence of the cost consciousness of higher gasoline prices."

Comment: What is meant by this analysis? No evidence is offered to support the claim; none of it proves that U.S. parts makers will gain a larger share.

Lines 14-18 Repeats Management Perspectives Inc.'s premises that the independents' share will grow from 50% to 60%, while the dealers' share declines from 50% to 40%.

Comment: These premises are without substantiation.

Lines 18-20 The report draws the conclusion that "the sale of replacement parts outside the Japanese car dealer channel will double in the coming five years to 1985."

Comment: It is hard to accept this 100% increase in outside dealer sales, in light of the problems with the projected dealers' share decline. Also, even if the decline figures are accepted, the most important figure to look at is the rate of change for independents, a 20% gain between 1980 and 1985, a far cry from what the 100% increase portrays.

C. Sales Status of U.S. Independent Channel for Japanese Vehicle Replacement Parts (Exhibit 1-9)

Lines 23-25 Cites survey by Warehouse Distribution magazine, reporting 86.3% of warehouse distributors surveyed "handle car parts for import vehicles."

Comment: This fails to address the issue of Japanese car parts, clouding the issue by asking "do you stock replacement parts for import vehicles?"

To have any meaning, the figures would have to be broken down to show Japanese parts handled, and the magnitude of the Japanese lines they handle.

Lines 27-31 Cites reports by "94.6%" of warehouse distributors surveyed that they procure parts for import cars from U.S. parts manufacturers producing such import car parts. "This shows that U.S. parts manufacturers are actively participating in the market for import cars."

Comment: It shows nothing from which to draw such conclusions. What is meant by the figure? Is it one line of parts for Japanese cars, or is it only one item for Japanese cars? Does it, perhaps, mean VW, and no Japanese business? What is the magnitude of purchases of actual U.S. made parts for Japanese vehicles? None of this is portrayed.

No one can draw a valid conclusion from this "information" that U.S. parts makers are actively participating in the parts market for foreign imports, much less actively participating in the parts market for Japanese imports.

Exhibit 1-9, from which the 94.6% is drawn, also shows 26.2% of the respondents saying that they buy replacement parts for import cars from an importer (parts of foreign origin, bearing tradename of foreign manufacturer) or direct from foreign car manufacturers or agents outside U.S., which drew 4% response.

Comment: These two non-U.S. sources total to 30.2% of the respondents. It is impossible to tell the relative shares of purchases assigned to the two latter groups versus the weighted share of the 94.6% responding that they buy from U.S. manufacturers.

Lines 32-35 The report concludes "Further, from the fact that approximately 80% of the warehouse distributors reported that they consider import parts business profitable," and "they intend to and will be expanding their lines and coverage of replacement parts for Japanese vehicles in relation to the growth in U.I.O. and increasing vehicle age of Japanese vehicles."

Comment: JAMA draws this conclusion from the preceding faulty premise.

What buttressed these claims? What evidence is offered? Though no breakdown is given anywhere for Japanese units, all of these conclusions are drawn for Japanese imports. Nowhere was the extent of coverage of Japanese vehicles mentioned, and it is impossible to make such glowing predictions for the future.

Section 3. Service Availability for Japanese Vehicle Parts (Exhibit 1-10)

A. Service Capabilities of Dealer Channel

Page 6, Line 1 -- Cites Exhibit 1-10, Comparing Japanese and U.S. car dealers.

<u>Comment</u>: While three sources are listed, including JAMA, it is not mentioned who specifically should get the credit for the information, and who supplied which information.

No mention is made of any overlap between domestic and Japanese dealers. It would be helpful to know the number of dealerships handling both domestic and Japanese makes.

Lines 3-4 "For Japanese vehicles in the U.S., as there are fewer dealers than for U.S. domestic make vehicles, the absolute number of service outlets is limited."

<u>Comment</u>: Certainly no comparative disadvantage may be drawn from this very relative statement.

Lines 5-12 "...both the U.I.O. per service bay and U.I.O. per mechanic for Japanese vehicles are lower than for domestic makes. This can be interpreted to mean that the Japanese dealer channel does not fall below that of U.S. domestic car dealers, and that the Japanese car dealer channel has the capability to offer vehicle owners an equivalent level of service."

<u>Comment</u>: Who has made this interpretation, on what grounds, and by what procedures?

Lines 13-16 Shows the parts fill rate of Japanese car distributors for four leading Japanese imports as very similar to U.S. auto makers supply rates.

<u>Comment</u>: The figures actually show just how actively the Japanese participate in their dealer channel.

B. Satisfaction of Japanese Car Owners in the U.S.

Lines 17-19 In the matter of satisfaction, the report notes "although various owner surveys are carried out, according to certain surveys of import cars, the following results have been noted."

Comment: What are the "various owner surveys (that) are carried out"? Why were these "certain surveys" results noted?

1. MEMA (Exhibit 1-11)

Lines 20-24 Cites MEMA owner survey, 1978. Of American small car owners surveyed, 76% felt American small cars are easier to get serviced, while 2.8% felt foreign small cars are easier to get serviced. Results shown in Exhibit 1-11.

Comment: This does not pertain to the Japanese vehicle issue. If "various owner surveys are carried out", why is this one chosen, which does not specifically mention Japanese vehicles?

Lines 25-26 JAMA qualifies the MEMA findings. "It must be noted that this survey was merely an expression of owner presumption and was not one of owner experience of difficulty in obtaining service."

Comment: So, it is a matter of owner presumption versus owner experience -- not much of a survey finding.

What cars did the respondents own, and how much can be construed as presumption versus experience? Surely, there must have been some owner experience if 76.8% could answer that American small cars were more easily serviced, as opposed to 2.8% who felt foreign small cars were more easily serviced.

2. TIME Marketing

Lines 27-30 Cites the satisfaction of 800 Datsun 200 SX owners surveyed.

Comment: Now JAMA shifts to a comparison with survey results of 800 Datsun 200 SX owners, a very specific pool versus the undefined pool above.

3. MONEY Magazine

Lines 31-36 Cites August, 1980 Money magazine report of survey results compiled by Mr. Peter Bohr. Bohr surveyed 25,000 vehicle owners.

Comment: No explanation is offered for who Peter Bohr is, and there is no exhibit showing the results.

No specific figures are advanced showing that "the owners of Toyota, Datsun, Honda vehicles expressed a higher level of satisfaction with their dealer service than surveyed owners of U.S. domestic small cars."

One would presume that JAMA is not calling this one "owner presumption."

Lines 35-36 Also noted, but do not show: "For the large majority of Japanese makes, parts were readily available."

Comment: What is meant by the "large majority?" For what share, "small minority", were parts not readily available? Why not carry the argument further; having said that owners were more satisfied with Japanese than domestic, how many felt parts were readily available for U.S. domestic small cars?

4. John C. Maloney & Associates, Inc. (Exhibit 1-12)

Page 5, Line 1 Cites Exhibit 1-12, Maloney study of 15,000 small car owners.

Comment: One drawback is that while it mentions Toyota, Datsun, Honda specifically, it does not list the "other imports" surveyed or the "competitive domestics" surveyed.

Lines 7-9 JAMA concludes: "Judging from these surveys, Japanese car owners are relatively satisfied with the service parts availability of Japanese car dealers which is comparable to the level of satisfaction of domestic U.S. makers."

Comment: JAMA draws its conclusion from some rather suspect survey material.

While JAMA notes the strong satisfaction, it brings into question the steep decline of 20% which they project for their dealers over the next five years, a rate of decline double the 9% they portray for U.S. dealers (Page 5, Line 17-18)

C. Service for Japanese Vehicles Outside the Dealer Channel (Survey results showed the following.)

1. Import Car magazine (Exhibit 1-13)

Lines 12-15 Using Exhibit 1-13, (Import Car survey of 1,750 service outlets for import cars), JAMA states in lines 14-15 that it "showed that almost all types of service for import cars are being performed by such outlets."

Comment: None of this is pertinent to the discussion of Japanese imports. Exhibit 1-13 shows indeed, that in varying degrees of percentage shares, every type of service is performed by outlets on imports. It does not portray the percentage of respondents performing each type of service for Japanese imports.

Line 16-18 "In particular, over 90% of all outlets surveyed reported that they offered engine tune-up, brake, shock absorbers, engine hard parts and electrical repair service for import vehicles."

Comment: JAMA says "in particular", but this high rate is not broken down for Japanese vehicles, and is of no relevancy to the discussion.

Also, as noted, this percentage of respondents reported they "offered" services. Offering of course is very different than actually performing.

Lines 19-20 "Further, two-thirds of the outlets surveyed offered various types of service for Japanese vehicles."

Comment: JAMA finally gets down to some figures, but they are not statistically relevant. One does not know of the two-thirds that offered the service how much business each had for Japanese vehicles in each type of service.

2. Brake and Front End magazine (Exhibit 1-14)

Lines 21-23 Using Exhibit 1-14 (Brake and Front End 1979 survey), "84% of retail service outlets surveyed offered some type of service for import vehicles."

Comment: Again, this does not address the Japanese import issue. Nowhere is any empirical evidence presented regarding volume of Japanese import business at these outlets.

Line 24 Reports "imports accounted for 16.8% of overall sales."

Comment: Again, there is no breakdown for Japanese imports. Of the significant portion responding that they offered services, 16.8% of the overall sales were for imports. The recurring deficiency is the lack of a breakdown for Japanese imports.

3. Irving Cloud Publishing Co.

Lines 26-28 Cites the 1979 Irving Cloud Publishing Company survey findings that 89% of ~~all~~ jobbers surveyed handle parts for import vehicles, and more than 80% maintain a machine shop for necessary import car services.

Comment: It says nothing about the degree to which jobbers handle parts for Japanese vehicles or perform machine shop services for Japanese imports. Again, it is vastly different to offer services than to actually perform services for Japanese imports.

There is no exhibition of these survey results.

4. A.T. Kearney Inc.

Lines 30-31 Cites A.T. Kearney, Inc. findings that "80% to 90% of warehouse distributors and jobbers surveyed handle replacement parts for Japanese vehicles."

Comment: Although A.T. Kearney Inc. is JAMA's contractor, the nebulous "80% to 90%" results are not exhibited.

There is no adequate description of the population surveyed.

Lines 32-34 Notes the majority had a limited line of parts for Japanese vehicles.

Comment: What specifically is the "majority?" What is meant by "limited line"?

These nebulous figures contrast sharply with the glowing report made on Page 5, Line 23-27. Of the warehouse distributors surveyed, 86.3% reported that they handle parts for import vehicles, a sharp increase in comparison with the status in 1973, when the survey showed that 65.5% of the warehouse distributors handled import parts.

Taking the two together, the real conclusion might be stated: while many more warehouse distributors handle import parts in 1980 than did in 1973, their handling of Japanese parts is very limited. So, what happened to all the growth?

Page 8, Line 1-2 "Further, in 1980 5% to 10% of the warehouse distributors, jobbers were handling a full line of replacement parts for Japanese vehicles."

Comment: Indeed, the majority had a limited line. While it does not say it, this means A.T. Kearney found that 90%-95% of warehouse distributors and jobbers had no full line, but degrees of limited lines. How "limited", cannot be discened from this vague report.

Page 8, Lines 2-3 JAMA concludes: "By 1985, this (percentage handling full Japanese line) is estimated to increase to 20% to 30% of all warehouse distributors and jobbers."

Comment: JAMA draws its conclusion from the preceding shaky figures. Who estimates this increase, and on what statistical basis?

The estimated increase is especially suspect in light of the wide gap between the growth rate in warehouse distributors handling import lines and the small number that now handle a full Japanese line.

Lines 4-7 JAMA draws the conclusion: "Thus, from the above, it can be concluded that even outside the dealer channel, service for Japanese vehicles is available to a wide extent and that owners of Japanese vehicles can obtain an equitable level of service for their vehicles."

Comment: JAMA's information, if anything, truly shows how very improbable it would be for U.S. independent channels to pick up a 20% share in the market to compensate for the wildly improbable projections for a 20% decline in their dealers' share.

Comment on Chapter I: The entire chapter flies in the face of Japan's own stated commitment in the Trade Facilitation Committee (TFC) process. According to a Commerce Department source, the Japanese have promised to take some steps to open up their dealerships. This report contradicts those intentions, insisting that the Japanese need not do anything. According to the report's Introduction, it indicates "the direction that we feel should be taken to result in increased participation by U.S. manufacturers in the U.S. replacement parts market for Japanese vehicles." (Page 2, Lines 17-18)

CHAPTER III. ADOPTION OF U.S.-MADE AUTOMOTIVE PRODUCTS -present and future-

Section 1. U.S.-made Automotive Products Handled by Japanese Car Distributors

Page 26, Lines 1-5 Reports that "each Japanese auto maker has continued to adopt U.S.-made automotive products for the U.S. market as produced by the U.S. automotive manufacturers to the greatest degree possible with full efforts to promote and sell such automotive products through their Japanese car dealers in the U.S."

Comment: What is meant by the "greatest degree possible" and the term "full efforts to promote and sell such automotive products through their ...dealers in the U.S."? No evidence for these claims is offered.

Lines 6-7 "And, at present, each Japanese auto maker is handling a large volume of U.S.-made automotive products."

Line 8 To buttress the claim in Lines 6-7, JAMA introduces its own compiled statistics. (Exhibit 3-1)

Comment: Exhibit 3-1 is entitled "Japanese Car Distributors' Purchase of U.S.-made Automotive Products." It is noteworthy that the report now speaks of automotive products of U.S. manufacturers rather than parts. What is the significance of this change of terminology?

It is also significant that while the title of the exhibit uses the term U.S.-made automotive products, in the text discussing the exhibit, (Lines 8-11), JAMA notes that "in 1979, Japanese auto makers exported $350 million worth of REPLACEMENT PARTS to the U.S. And, their purchases of U.S.-made AUTOMOTIVE PRODUCTS amounted to $150 million in the same year." (emphasis added)

Exhibit 3-1 does not show a figure for "each Japanese auto maker," even though JAMA is the source cited. The chart shows a phenomenal growth in Japanese export shipment of replacement parts from 1977 to 1978. Sales increased 40.3% from $248,034,000 in 1977 to $347,996,000 in 1978. During the same period, JAMA reports that Japanese distributors increased purchases of U.S.-made automotive products from $80,359,000 in 1977 to $85,315,000 in 1978, a change of approximately 6.2%.

Then, one is expected to believe that after a period of 40.3% growth in replacement parts exports, the Japanese actually decreased their parts exports from the 1979 figure of $347,996,000 to $347,283,000 (1979). Thus, after a period of rapid growth, the Japanese follow with a decline. But in their same period of decline, it is alleged that purchases of U.S.-made automotive products grew at a rate of about 78%. Only the year before, it had grown at 6.2%. To what is this due?

Lines 11-14 JAMA claims that the "rate of local purchases of U.S.-made automotive products (100) as compared to the export value of replacement parts comes to 43.4% points, a very high rate."

Comment: This growth is from a very small base, which is not mentioned. The important comparison to be made in Exhibit 3-1 is the percentage shares. When comparing, the Japanese have 70% and the U.S., 30%. So much for "very high" rates.

Lines 14-16 "This trend can be interpreted and forecasts that each Japanese auto maker will be making efforts hereafter in accordance with the growth of the Japanese vehicle market in the U.S."

Comment: It is never explained how this trend is interpreted. Should it be interpreted to mean that Japanese shipment of replacement parts to the U.S. will continue to decline? Is that the trend of the future?

It does not show anywhere who is forecasting or how a forecast is made for "each Japanese auto maker" to make "further efforts hereafter in accordance with the growth of the Japanese vehicle market in the U.S."

Section 2. U.S. Parts Manufacturers' Participation in the Replacement Parts Market for Japanese Vehicles

A. Status of U.S. Parts Manufacturers' Participation

Lines 20-23 "As previously stated in Section 1 of Chapter 1, approximately 50% of the total market of $1.06 billion for Japanese replacement parts is sold outside the dealer channel in the U.S. Thus it can be noted that many U.S. manufacturers are actively participating in this market."

Comment: How is this conclusion reached that if 50% is outside the dealer channel, it can be noted that many U.S. manufacturers are active in the market?

Does the term "many U.S. manufacturers" refer to manufacturing of automotive products or replacement parts? The discussion has changed back to replacement parts.

Lines 24-27 Cites Warehouse Distribution survey, Exhibit 3-2, that 88% of U.S. parts manufacturers "have increased the number of items for import cars." The population studied here is the U.S. parts manufacturers manufacturing/selling import car parts.

Comment: What is the difference between manufacturers manufacturing import car parts versus those that manufacture and sell import car parts? For example, a manufacturer may only manufacture one item for imports but may sell many lines of parts made overseas.

They were asked if they "have increased or decreased the number of import car items in your lines during the years you have been offering them?" Nowhere is this discussed or broken down to show plans for increasing Japanese items or an actual increase in items for Japanese cars.

Exhibit 3-2 also shows manufacturers response to the question: "Approximately what percent of your total dollar volume of import car parts is represented by the following makes?" Toyota, Datsun, Honda, Subaru, and Mazda totaled to 61.1%.

This offers no gauge of success. What needs to be shown is the percentage of total dollar volume of all parts represented by each Japanese make. While 3-2 shows 88% planning an increase in their import item lines, Exhibit 3-7 shows that of the same pool of respondents, 68% include in their future plans "wide coverage for top makes of imports."

Again, none of this addresses the Japanese import issue. The 88% planning a line increase times the 68% planning "wide coverage" total to only 60% of the respondents planning wide coverage for imports.

Figures cited in Chapter I do not support Chapter III contentions of active U.S. manufacturers participation in the Japanese aftermarket. In fact, the "givens" in Chapter I were: 1) 86.3% of warehouse distributors handle parts for imports (no breakdown for Japanese), up from 65.5% in 1973; (2) and 94.6% of warehouse distributors procure parts for import cars (no specifics on Japanese) from U.S. parts manufacturers producing such import car parts; STILL (3) only 5-10% of warehouse distributors had a full line of Japanese items and the vast majority had extremely limited lines.

Lines 27-30 Report cites Exhibit 3-3, which shows "at a glance" the "import car parts items handled by each of the 250 U.S. parts makers/suppliers."

<u>Comment</u>: This in no way addresses items for Japanese cars, nor is any evidence provided for the percentage share of business represented by items in a line.

Lines 31-35 Report cites Exhibit 3-4. It presents a list of 22 U.S. parts makers and is entitled "Survey of U.S. Parts Makers Producing, Procuring Japanese Car Parts."

<u>Comment</u>: Exhibit 3-4 is fraught with problems. The descriptions of coverage range from "% coverage" to "all popular imports," "most popular Japanese and VW," and "Japanese and VW." What are "all popular imports"? How does this differ from "most popular Japanese and VW"? Of this, how much is for "most popular Japanese" versus "most popular VW"?

Terms are used such as "all major imports," "most major imports," and "most imports." How does "all major imports" differ from "most major imports"? How does "most imports" vary from the above two?

Another classification is "all top lines." What does that mean? No explanation is given for the term "Datsun Only-Expanding." The same criticism applies to the "major import--70% coverage term. Also listed is "Toyota, Datsun and VW only," but no mention is made of the relative shares held by each.

Only in seven cases were the parts 100% U.S.-made, with others listing varying degrees of procurement from abroad. Since comparisons are impossible, the results have no value, and the number studied is insignificant.

B. U.S. Production of Replacement Parts for Japanese Vehicles

Page 27, Lines 2-4 Cites Exhibit 3-5 survey results that "66% of all manufacturers surveyed are producing parts for import vehicles.

<u>Comment</u>: This does not address the Japanese aftermarket issue.

This paper's previous analysis showed that even if 66% manufacture any type of replacement parts for imports, very few have anything but limited lines for Japanese imports. (Nowhere of course, is any of this related to U.S. difficulty in entering the Japanese original equipment (O.E.) market.)

Furthermore, if one takes the 88% of so-called U.S. parts manufacturers manufacturing/selling parts for imports who plan to increase their lines (not specifically Japanese) times the 66.2% who make any type of import parts, one finds that only 58% of U.S. parts manufacturers make parts for imports and plan to expand their product lines. This means that about 42% of all U.S. parts manufacturers either make no such parts or do not plan to increase lines if they do make them.

Lines 5-8   Cites Exhibit 3-6, entitled "The Status of Japanese Car Parts Production by U.S. Parts Makers." The source of the survey is JAMA contractors A.T. Kearney and Management Perspectives, Inc.

Comment: In Part I, eight examples are given of U.S. makers "producing almost all applications of replacement parts for Japanese vehicles."

What is meant by almost all applications? For which makes and models? For one make and model, or two or three? Also, no value is stated anywhere for the volume of Japanese purchases compared to domestic sales.

In Part II, five examples are given of U.S. makers producing limited items. What in the world does "limited" mean? Nowhere is spelled out how many makes, models, or percentage of total sales involved. Just because they make it does not assure that the Japanese are buying any appreciable amount.

The 13 examples given are such a small number that the findings have no statistical value. What is needed is a random sample; a scientific study.

Lines 9-12   The report cites "Small Japanese U.I.O. and the rather young age of the U.I.O." as the reasons why the "current situation with overseas affiliate companies or by importing is sufficient."

Comment: The two reasons cited are specious. This, finally, is JAMA's admission, and after all of its report's strivings to show how actively U.S. manufacturers are participating in the Japanese replacement market.

C. Outlook

Lines 25-26   The report confuses a 95% figure found in Exhibit 1-9.

Comment: Exhibit 1-9, which this paper disputed, showed that 95% of warehouse distributors selling import car parts purchase replacement parts "from U.S. manufacturers who also make import car parts." This has absolutely nothing to do with the claim that "95% of the import car parts handled by warehouse distributors are purchased from U.S. parts manufacturers."

Lines 27-29 JAMA draws the conclusion that warehouse distributors "will certainly be a major pressure and influence on U.S. parts manufacturers to expand their import car parts line and production facilities."

Comment: While this conclusion bears some truth, it is essential that there first be more open dealerships and meaningful access to the Japanese O.E. market.

Page 28, Lines 1-3 Notes that increasing trend to small car production in the U.S. will "place greater emphasis on production technology and facilities for small car parts."

Comment: There will never be any meaningful trend without a better U.S. share in the Japanese O.E. market.

Lines 3-6 "As the market participation of U.S. parts manufacturers accelerate added to the initiation of vehicle production in the U.S. by Japanese auto makers, it needs no explanation that the production of parts for Japanese vehicles will develop dramatically."

Comment: This statement requires a great deal of explanation for the anticipated dramatic effects. This is based on the questionable premise of accelerated U.S. participation.

It leaves out ~~an~~ important condition, that of future Japanese parts production in the U.S., tied to "vehicle production in the U.S. by Japanese auto makers."

Lines 5-6 The report concludes that "production of parts for Japanese vehicles will develop dramatically."

Comment: It is noteworthy that JAMA chose the phrase "production of parts" rather than saying "U.S. production of parts" for Japanese vehicles will develop dramatically.

Lines 7-10 The report concludes: "Although a portion of the replacement items (for Japanese cars) may not be feasible for production by U.S. parts makers in terms of economic lot production, it can definitely be said, that in general, the opportunity for U.S. parts makers in the replacement parts market for Japanese vehicles will increase more and more."

Comment: The conclusion is a classic understatement. It makes no note, of course, of O.E. market entry and dealer impediments to production of more than just a portion of replacement items.

The second part of the conclusion is rather non-sensical but optimistic. It states "in general" there will be increasing opportunities, but as throughout the report, one never learns the specifics. A general conclusion drawn from many generalities.

APPENDIX D

Joint Report of the First Monitoring Meeting of the Automobile Components Purchasing Mission

Prepared by the U.S. Department of Commerce and the Japanese Ministry of International Trade and Industry

Tokyo, Japan, February 6, 1981

1. Preface

The First follow-up meeting on the automobile components purchasing mission took place at the Japanese Ministry of International Trade and Industry (MITI) on February 5, 1981. The components purchasing mission has as its purpose to increase purchases of U.S.-made automobile parts for use in Japanese cars in the United States and Japan.

The follow-up meeting examined the results of surveys conducted by MITI and the U.S. Department of Commerce (USDOC) on the status of U.S.-Japanese business activities in the post-mission period.

Both U.S. and Japanese participants recognize that decisions to purchase automobile components require a considerable period of time because of the need to exchange information and evaluate products. The following is a preliminary progress report which will serve as a benchmark against which future progress can be measured.

2. Survey Results

(1) Summary

Both governments are satisfied with progress to date. Several purchase contracts for automobile components have been agreed to since the mission. About thirty contract negotiations are already under way; Japanese firms have placed sample orders with and requested price quotations from a large number of U.S. component producers. U.S. participants are for the most part satisfied with the timeliness and sufficiency of Japanese responses and are optimistic about prospects for sales. The surveys show, however, that price and quality remain problems.

According to MITI, automotive component purchases in 1980 by Japanese auto manufacturers from U.S. suppliers reached $139 million, about a 70 percent gain over 1979. (U.S. statistics show a figure of $103 million, due primarily to differences in commodity classification.) However, both Japanese and U.S. participants must make greater efforts if purchases of automobile parts by Japanese manufacturers are to increase to the $300 million level in 1981 forecast by the Japanese participants in September 1980 and if they are to continue to show significant gains thereafter.

(2) The Replacement parts market for Japanese cars in U.S.A.

According to a report commissioned by the Japanese Automobile Manufacturers Association (JAMA), the replacement parts market for Japanese cars in the U.S. reached $1.06 billion in 1980. About half of this market is supplied by independent garages and retailers, i.e., suppliers not tied to Japanese manufacturers. The replacement parts market in the U.S. is expected to increase to $1.85 billion in 1985. The market share of "independents" is expected to increase to 60 percent. Japanese firms will make further efforts to purchase more U.S. produced parts for Japanese cars in the U.S. With a view toward facilitating participation in this market by U.S. parts makers, JAMA will distribute the contents of this report to U.S. importers and distributors and others concerned. JAMA will further dispatch an expert to the USDOC-sponsored seminar to be held in Detroit in March to instruct U.S. suppliers how to sell to this market and will present studies of successful sales efforts.

USDOC found this report useful in clarifying existing market relationships and will be looking forward to seeing what other steps will be taken by the Japanese manufacturers to increase U.S. company participation in this market. The replacement parts market for Japanese cars in the U.S. will be further discussed at the next monitoring meeting planned for August 1981.

USDOC will welcome comments by U.S. companies on their progress in participating in this market. Complaints will be investigated by USDOC and communicated to MITI; MITI will investigate and respond promptly.

3. Future Work

Both Japanese and U.S. participants are committed to continuing discussions begun during the mission and to seeing these discussions lead to significant purchases.

The U.S. Department of Commerce has organized the "Selling of Original Equipment Auto Parts to Japan" seminar/workshop to be held in Detroit on March 5-6, 1981. JAMA and the Japanese auto parts industries association will provide speakers for this seminar/workshop with a view toward increasing U.S. supplier understanding of the Japanese auto parts market.

MITI and USDOC will continue to monitor results of the mission and overall auto parts exports to Japan. The two sides will meet again in August 1981 to compare their assessments and to discuss specific problems encountered in facilitating increased purchases of U.S. auto parts for use in Japanese cars in the United States and Japan.

Senator DANFORTH. Thank you very much.
Mr. Galster.

STATEMENT OF GEORGE M. GALSTER, VICE PRESIDENT FOR INTERNATIONAL SALES, CHAMPION SPARKPLUG CO., AND CHAIRMAN, AUTOMOTIVE PARTS EXPORT COUNCIL, TOLEDO, OHIO

Mr. GALSTER. Thank you, Mr. Chairman.

I am delighted to offer my comments to this committee because just a week ago I returned from Japan, after leading a trade mission organized by the Department of Commerce for the intention of selling original equipment auto parts in that country.

Actually, my involvement with the Japanese manufacturers goes back quite a number of years. My first trade mission was in 1969 to Japan, and at that time we were quite excited when we got a promise from the Japanese to study the problem of purchasing more U.S. parts.

Back in September of last year, I happened to be the keynote speaker for that Japanese parts purchasing mission. Then last March, in Detroit, when they had a 2-day seminar to try and teach us how to sell original equipment spark plugs and parts to Japan, I happened to be the chairman of that group.

In my company's capacity, I should say that I visited Japan dozens of times in the last 15 years, and I am pleased to report that my company has been relatively successful in selling products to such manufacturers as Mitsubishi, Fuji Heavy Industries, Honda, both cars and motorcycles, and practically all of the motorcycle manufacturers in Japan. However, we continue to be concerned by a number of factors which we see.

First of all, our product, our spark plugs are supplied by our Canadian plant, and that is due to the very fine incentives that the Canadian Government gives to the Japanese manufacturers in the form of duty remission to purchase product made by Canadian labor.

Second, virtually none of the engines in which we install original equipment are sold in the Japanese home market. When automotive parts and components are purchased from U.S. companies, almost invariably the engines or vehicles in which they are installed are transported back to the United States.

Finally, as a result of these factors, American auto part suppliers are virtually locked out of the aftermarket, both in Japan and in third countries where Japanese vehicles often dominate the car population.

Maybe it would be of interest to relate a couple of observations about our recently completed auto parts selling mission to Japan. Certainly, we were cordially received by high level management. Second, the visit was extensively covered by the media. Third, while none of us really expected to sign any purchase orders as a direct result of the mission, we did enable ourselves to collect a lot of calling cards.

The companies which had been actively pursuing business in Japan believe that many new opportunities and new doors were opened. However, the companies that were new to the market had reactions ranging all the way from discouragement, to perhaps mild enthusiasm.

The Japanese vehicle manufacturers laid down some rather practical businesslike criteria for increasing their purchase of American parts. They said, first of all, offer something new in design or technology; second, meet our on-time delivery requirements; third, adhere to our quality specifications; and finally, offer us delivered prices lower than what we can purchase locally.

As mission leader, I agreed that these were very practical businesslike criteria. I pointed out, however, that any one could be a convenient "no pass" excuse for not purchasing foreign products. As a result, I urged them, first, to speed up their engineering approval test of U.S. products; and, second, that business negotiations should be conducted without regard to traditional, cultural, or national preferences, nor consideration of the extensive equity interests which the vehicle manufacturers have in their own part suppliers.

The other thing of interest is that the Japanese seemed unaware of the fact that the primary level of U.S. part suppliers in our industry has about double the employment and certainly about double the unemployment of the vehicle manufacturers in this country.

They do seem to perceive, however, that they had better start moving forward in their programs to increase parts purchases because of the protectionist pressures which are being talked about both here and in Europe. I only hope that they appreciate the urgency of the matter, and that we have sufficient incentive for them to push ahead.

I certainly must also say that it is important that U.S. producers demonstrate the guts and the wherewithal to really meet these Japanese requirements.

In closing there are three points that I would like to comment on.

First of all, I would like to see us maintain the present 25 percent duty on light trucks. The Japanese are making increased use of our duty drawbacks, so in these vehicles at least we will eventually see some significant increase in local content made by U.S. parts manufacturers.

Second, auto parts per se now enter Japan duty free, but there are many examples, such as glass which carries 9.2 percent duty, tires 5.8 percent, ignition cable 8.9 percent, and so on, which the Japanese import under bond, and then send back to this country to collect the duty, in effect, back from the Japanese Government. That keeps us out of these Third World countries for our products.

Third, we are aware of the special protection and the tax incentives which, beginning in 1956, and for at least a couple of decades thereafter, fertilized the unnatural growth in productivity and price competitiveness of the Japanese parts industry.

Today, this industry still remains a direct beneficiary of MITI's unique computer industry development policy. We can offer, as a part supplier industry, high technology, we can meet their delivery and quality requirements, but it is certainly tough to compete on price when the companies in Japan are offered special depreciation allowances and low cost loans to install computer-controlled industrial machinery and robots.

I think this is going to be a situation that is going to effect significant differentials in our total cost picture, quite aside from the various differences in labor costs.

Thank you very much.

Senator DANFORTH. Thank you.

I am told that with respect to the aftermarket in the United States for parts, the Japanese require a specific certification process. I am not sure how it works, but the effect of it is to seriously limit the use of American parts as replacements for parts on Japanese cars sold in the United States.

Do you understand how that works, and could you explain it?

Mr. MORRIS. I think I do, Senator. Aside from the so-called beauty items, trim items, the Japanese car manufacturers will require engineering approval of any parts or accessories in general before they can be sold through the parts network of the vehicle manufacturers in this country. Of course, that is a very convenient tool to delay acquisition of U.S. parts.

Senator DANFORTH. How is this done? Is this done just once, and then once you have a part certified, you are in the clear?

Mr. MORRIS. Yes. Generally, the test is made for each particular engine model or vehicle, depending on the particular part, and that becomes a complete certification as long as those supplies continue to meet quality standards. Those are audited from time to time, and if they do not meet quality standards, then the approval is withdrawn.

Senator DANFORTH. Where are they audited?

Mr. MORRIS. Generally in Japan.

Senator DANFORTH. So that it is not just a single event, but there are series of shipments of American parts to Japan for the purpose of inspection and certification, and auditing; is that correct?

Mr. MORRIS. That is correct.

Senator DANFORTH. Would that be viewed as a barrier to trade?

Mr. MORRIS. No, sir, I would not view that as a barrier to trade. It is quite a normal way of doing business. Most U.S. car manufacturers would follow the same procedure before they would permit any replacement parts to be sold through their own networks, too.

Mr. GALSTER. It is also odd, in connection with that particular procedure, for otherwise efficient people, how when it suits them they can be very, very inefficient.

Senator DANFORTH. Meaning what?

Mr. MORRIS. Meaning that it is slow.

Senator DANFORTH. Slow.

Mr. MORRIS. Slow. In many cases, it is a matter of years, and of course the ultimate price of the product goes up the longer it takes, and the more difficulty you have. Consequently, you wind up, when you finally do get the approval, with a product that perhaps is no longer competitive in price. These are, as you characterized them, nontariff sorts of barriers.

Senator DANFORTH. Could you describe by example one or two of the barriers with respect to selling American parts?

Mr. MORRIS. As a matter of fact, it is in the record of the hearings before the Senate Select Committee on Small Business, where-in we do have documented instances where barriers of this sort and others were imposed, making it difficult and ultimately more expensive for us to compete in that marketplace.

I can recall from memory, and I have it here, and I would be happy to leave a copy with you, Senator, the case of hoses. For instance, we came back and forth, and back and forth. One of our manufacturer members stuck with the process until he thought he had the order in hand, and something at the very, very last minute that was seemingly unrelated to the transaction took place, and we never did get the order. All kinds of excuses were given, some of which were substantive in nature, but nonetheless the end result was very, very clear.

Senator DANFORTH. Are our markets open to the Japanese for parts?

Mr. MORRIS. Sure.

Senator DANFORTH. They can sell parts that could be put on a GM product?

Mr. MORRIS. Yes.

Senator DANFORTH. How would you compare the openness of the American market versus the Japanese market?

Mr. GALSTER. There are cars assembled here that have American marks on them, and that have components from around the world, the so-called World Car, including Japan. The makers and the producers from all around the world have access to markets here, to the vehicle itself.

As far as the aftermarket is concerned, whatever is in that car at the outset when it is made, it is the basis for the aftermarket industry worldwide. With a Japanese car, you don't have that. A Japanese car is a Japanese car.

Senator DANFORTH. Thank you very much.

[The prepared statement of George M. Galster follows:]

George M. Galster

Vice President International Sales

CHAMPION SPARK PLUG COMPANY

Chairman

AUTOMOTIVE PRODUCTS EXPORT COUNCIL

I am delighted to offer my comments to this Committee. Just a week ago I returned from Japan after serving as the leader of a Commerce Department trade mission which was organized to sell original equipment auto parts in that country.

My involvement with the Japanese vehicle manufacturers goes back some years. My first semi-official visit was in 1969 as a member of a Michigan Trade Delegation. I was the keynote speaker in September, 1980 when the Japanese sent a parts purchasing mission to this country. I also served as chairman of the two-day seminar in Detroit last March when the Japanese delegation taught us how to sell them original equipment auto parts. Our export council, incidentally, video-taped those sessions for the benefit of U.S. firms which could not attend.

In my company's capacity, I've visited Japan dozens of times; I'm pleased to report that we've been relatively successful in selling product to such manufacturers as Mitsubishi, Fuji Heavy Industries, Honda (cars and motorcycles), Yamaha, Kawasaki and several small engine builders.

Never-the-less, we continue to be concerned by a number of things:

1. Spark plugs supplied for automotive use are mostly supplied by our Canadian plant.

2. Virtually none of the engines in which we install original equipment are sold in the Japanese home market.

3. When automotive parts and components are purchased from U.S. companies, almost invariably the engines or vehicles are exported back to this country.

4. As a result of the preceding factors, American auto parts suppliers are virtually locked out of the aftermarket both in Japan and in third countries where Japanese vehicles often dominate the car population.

Perhaps it would be of interest to relate some observations of the recent auto parts trade mission to Japan.

1. Our mission was very cordially received by senior management levels of the car manufacturers.

2. The visit was extensively covered by the Japanese press and by NHK national TV.

3. While none of us really expected to sign any purchase orders as a direct result of the mission,

   a) companies which had been actively pursuing business in Japan believe that many new opportunities were opened,

   b) companies which were new-to-market had reactions ranging from discouragement to mild enthusiasm.

The Japanese vehicle manufacturers laid down some practical, business-like criteria for increasing their purchase of U.S. parts:

1. Offer us something new in design or technology.

2. Meet our on-time delivery requirements.

3. Adhere to our quality specifications, and

4. Offer delivered prices lower than what we can purchase locally.

As mission leader, I agreed that these conditions were entirely acceptable and had been often stated in the past. I pointed out, however, that any one of these criteria could be a convenient "no-pass" excuse for not purchasing foreign products. I urged that:

1. Engineering approval tests of U.S. products now be speeded up.

2. Business negotiations should be conducted without regard to traditional cultural or nationalistic preferences, nor consideration of equity interests in their own supplier companies.

The Japanese with whom we visited seemed unaware of the fact that the primary level of the U.S. parts supplier industry has about double the employment (and unemployment) of the U.S. car manufacturers. The Japanese do seem to perceive, however, that they must move forward with their programs of increased parts purchases to allay protectionist pressures both here and in Europe.

I believe that most Japanese companies are now sincere in their expressed desire to broaden their supplier base. Its a big job for them. I only hope they appreciate the urgency of the matter, and have sufficient incentive to push ahead.

It also is most important that U.S. producers demonstrate the guts and wherewithal to meet the Japanese requirements.

In closing, there are three points which justify comment:

First, let us maintain the 25% duty on light trucks. The Japanese are making increased use of our duty drawback, so in these vehicles at least, we will eventually see some significant percentage of local content.

Secondly, while "auto parts" per se can now enter Japan duty free, there are several important product categories which carry significant duty. Examples include windshield glass 9.2%; auto tires 5.8%; truck tires 7.5%; ignition cable 8.9%; floor carpeting 12%. The Japanese generally import these items under bond, then ship the assembled vehicle back to the country of origin. If we're really striving for free trade, we'd like to see these duties much lower so that U.S. products can be economically used in vehicles sold in Japan or exported to third countries.

Thirdly, we are aware of the special protection, and the special tax incentives, which beginning in 1956 and for at least two decades thereafter, fertilized the unnatural growth in productivity and price competitiveness of the Japanese auto parts industry. Today, this industry still remains the direct beneficiary of MITI's unique computer industry development policy.

American parts suppliers can offer high technology. We can meet delivery and quality requirements. But its tough to compete on price when small and medium size companies in Japan are offered special depreciation allowances and low cost loans to install computer controlled industrial machinery and robots.

Perhaps our industry can live with significant differentials in labor costs between this country and Japan. I continue to doubt, however, that free and fair international trade encompasses the concept of specific industry development incentives.

Thank you for the opportunity to address this committee.

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The next witnesses are Robert McElwaine, president of the American International Automobile Dealers Association; and Ralph Millet, president, Automobile Importers of America.

STATEMENT OF RALPH M. McELWAINE, PRESIDENT, AMERICAN INTERNATIONAL AUTOMOBILE DEALERS ASSOCIATION, ACCOMPANIED BY EDWARD G. CONNELLY

Mr. McELWAINE. Thank you, Mr. Chairman, for staying to hear us again. As always, we appreciate your patience. I am accompanied by Mr. Edward G. Connelly, who is chairman of the board of our organization, and a Volkswagen, Honda, and Alfa Romeo dealer in Cincinnati, Ohio.

Mr. Chairman, the last time we testified before this committee was in March of this year, just 9 months ago. At that time, we warned the committee that restraints on imported automobiles were certainly not going to ameliorate the problems of the domestic auto industry.

Instead, we said that strictures on imports, by creating an artificial shortage of small automobiles in the United States, would simply escalate the price of all automobiles sold here, costing the consumer billions of dollars in a mistaken effort to protect the domestic industry.

There is almost no satisfaction whatsoever, Mr. Chairman, in coming back here now and saying, I told you so, but that is exactly what has happened.

Import quotas, and the question of whether they are enforced by one nation, or adopted voluntarily by another, is purely academic in terms of the results; have certainly not helped the domestic industry.

Indeed, they have exacerbated their condition by removing price competition, and they tempted Detroit to go beyond the bounds of reason in price increases, both obvious and hidden ones. The obvious ones being the sticker price increases, and the hidden one being the 300-percent escalation in transportation charges which now average about $500 per car on a General Motors product, for example. The consequent sticker shock as much as outrageous interest rates has discouraged car sales even beyond what they would have been otherwise.

For consumers, import restraints have been a cruel joke, adding $4.5 billion to automobile costs in the current year, during a time of recession, inflation, and unemployment.

Additionally, the upgrading of the model mix by the Japanese has added another $800 million to the cost of Japanese cars.

The fundamental excuse offered for the imposition of quotas on Japanese imports was that this would permit the domestic industry to amass needed capital to carry out its now famous $80 billion expansion and modernization program, although after 2 years of this $80 billion figure, we have yet to see an analysis or breakdown of it, or any analysis of what portion of that is being spent in the United States.

How has the industry responded to this opportunity to amass capital? One, they have continued to pay dividends that in view of their poor earnings must be considered lavish. This spring, for example, the Ford Motor Co. paid more than $17 million in dividends to members of the Ford family alone.

They have continued their expansionary investment programs abroad, while scaling back and delaying capital investment in the United States. The Ford Motor Co. is building new plants in Europe and Mexico at this time. General Motors announced only a few weeks ago the purchase of 5 percent of the Suzuki Co. in Japan. Ford and its Japanese partner, Toyo-Kogo, have launched a joint venture in Hiroshima to supply engines and transaxles for Ford's automobiles here in the United States.

Much has been made of the losses suffered by the U.S. automobile manufacturers, and I caution the committee against attaching too much importance to the size of these figures until we see some analysis of where those losses occur.

Last year, you will remember, Mr. Chairman, there was a big flap about the fact that General Motors had just recorded the first loss in its history, and great blame was put on Japanese imports for causing that loss, until the annual report revealed that 92 percent of their loss took place in Europe, and only 8 percent in the United States.

I would like to see such figures. I would like to see what percentage of General Motors third quarter loss was due to their purchase of Suzuki Corp.'s 5 percent in Japan.

It is very disappointing, Mr. Chairman, to see no representation here at this hearing of Ford, General Motors, and Chrysler, to explain their operations under the Japanese restraint agreement, and their failure to utilize this so-called opportunity to retake some of their lost market share, or to amass their needed capital.

According to the last General Motors statement, they made a larger return this year on fewer sales than they did last year. Obviously, they are realizing a much wider profit margin on their cars this year than they did last.

The AFL-CIO representatives, Mr. Chairman, brought up the matter of domestic content law. We had not intended to testify on that subject, but since it has been raised, I would like to ask if we may submit, for the record, a brief study of the domestic content laws in the world that has been prepared for us, and have that included in the record.

Senator DANFORTH. Without objection.

[Report to be submitted follows:]

Critique of Proposals to Establish North American Content Requirements for Automobile Companies that Sell in the United States Market

PREPARED ON BEHALF

OF

THE AMERICAN INTERNATIONAL AUTOMOBILE DEALERS ASSOCIATION

I. Summary and Conclusions

A. The Proposal

The President of the United Auto Workers, Mr. Douglas Fraser, has announced that the UAW will seek legislation requiring automobile companies with substantial sales in the U.S. market to use high proportions of "North American content." At this time, main points of this proposal appear to be the following: by 1985, all automobile companies with annual sales in the United States of more than 200,000 units would be required to average at least 75 percent "North American content," and all automobile companies with annual U.S. sales exceeding 500,000 units would be required to average at least 90 percent "North American content." This proposal is intended to grant protection to U.S. and Canadian autoworkers beyond that already provided by the recent "voluntary" Japanese undertaking to restrict automobile exports to the United States, and by regulatory and tax relief that has been made available to the U.S. auto industry.

Had the UAW proposal been fully in effect in 1980, the 90 percent rule would have applied to Toyota and Nissan, as well as to General Motors, Ford, and Chrysler. Honda and Volkswagen would have been subject to the 75 percent requirements. Few, if any, of those companies, including the U.S. companies, would have met the requirements.

"Local content" requirements, such as those proposed by the UAW, have virtually the same practical effect as import quotas.*/ Indeed it is difficult to see how the proposals could be enforced except by means of formal quota restrictions that would prohibit the entry of vehicles in excess of the specified limits for manufacturers not meeting the "North American content" requirements.

There are other reasons why the UAW proposal would be counter-productive. It would undermine efforts by the Administration to secure the elimination of local content requirements by other nations. It would trigger a wave of restrictions by other nations that would hurt U.S. export industries. It would set an unusual and undesirable example of direct Congressional intervention in U.S. trade policymaking on behalf of a particular industry. And finally, the counting of parts and vehicles that are made in Canada as "North American content" would cause the United States to violate several of its international obligations.

B. The Congressional Research Service Study

In August, 1981, the Congressional Research Service (CRS) of the Library of Congress released a study entitled "Local

*/ See, e.g., John H. Jackson, World Trade and the Law of GATT (1969) at 289.

Content Laws and Automobile Imports: Arguments Pro and Con."*/ The principal observations that are made in the CRS study are consistent with our conclusions about the probable effects of U.S. local content legislation. The CRS study, for example, concluded that although U.S. local content rules might preserve some jobs for autoworkers and workers in U.S. auto supply industries, such rules also would:

- violate the General Agreement on Tariffs and Trade (GATT);
- possibly result in "reduced U.S. exports or increased imports elsewhere in the economy" that would offset any benefit to workers in the U.S. automobile and auto supply industries;
- harm U.S. auto producers;
- increase prices in the United States for both U.S. and foreign automobiles;
- impose burdensome bookkeeping requirements upon U.S. automobile companies and auto supply companies; and
- require modification of the U.S.-Canadian Automotive Agreement.

C. Summary of Proposals' Weaknesses

Our conclusions about why the UAW proposal would be bad law and worse policy are listed below and then are discussed

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*/ Dick K. Nanto, "Local Content Laws and Automobile Imports: Arguments Pro and Con," Library of Congress, Congressional Research Service, Report No. 81-191 E. August 20, 1981, hereinafter cited as "CRS Study."

more fully in the pages that follow. The proposal, if adopted, would:

- Be costly, inefficient, and inflationary;
- Undermine U.S. efforts to gain elimination of local content requirements by other nations;
- Be equivalent to an absolute import quota that would be far more restrictive than the current "voluntary" export undertaking by Japan;
- Involve indirect costs resulting from oligopolistic pricing in the U.S. market and weaker wage restraint on the part of the UAW;
- Be harmful to the U.S. auto industry by forcing U.S. auto companies to curtail sharply their captive imports of foreign-built models and their use of foreign-made components, thus raising costs for the companies and for consumers and preventing the companies from participating in the growing worldwide rationalization of automobile production;
- Cause the United States to violate its obligations under the General Agreement on Tariffs and Trade and under U.S. treaties of friendship, commerce, and navigation;

* Result in a loss of jobs elsewhere in the U.S. economy that would offset any gain of jobs in the auto industry.

Local content requirements have not been widely used by industrial countries for temporary protection against import competition. No major auto-producing nation has local content requirements for its auto industry. Local content requirements are not among the types of relief that can be recommended by the International Trade Commission in "escape clause" actions under section 201 of the Trade Act of 1974. They are not among the actions that the President is permitted by U.S. law to take in such cases.

In summary, the UAW is proposing special measures for its members in the United States and Canada at the expense of U.S. auto companies, U.S. consumers, other U.S. industries and their workers, and U.S. economy as a whole, and U.S. international economic relations.

II. Trade and Economic Consequences of the UAW Proposal

A. Domestic Content Requirements Would Be a Major Step Backward in Trade Policy

Local content requirements are unfair and ineffective measures for trade protection that are better suited to the trade warfare of the 1930s than to present trade relations. In recent years, these devices have been used, almost exclusively, by developing countries in pursuit of balance of payments and industrialization objectives. They have not been used by any nation with a significant automotive industry. Local content requirements are wholly inappropriate for a mature industrial country with global trade interests, such as the United States.

1. Attacking Foreign Local Content Requirements

Moreover, the Reagan Administration is committed to reducing the use of local content schemes by foreign governments. The "Statement of U.S. Trade Policy" that was issued on July 8 by Ambassador William Brock, the U.S. Trade Representative, explicitly calls for removal of foreign domestic content requirements and export performance requirements. Robert Hormats, Assistant Secretary of State for Economic and Business Affairs stated on May 19, 1981 that "we will want to insure that the international community vigorously addresses investment incentives and performance requirements, such as those which mandate local content or exports or a percentage of production, and thereby distort trade."*/ Secretary of State Alexander Haig stated on July 28: "Together we need to insure access to our markets for the products of poorer nations, to broaden developing country participation in the GATT codes, and to address the distortions - such as those imposed by investment performance requirements to international trade".**/ (Emphasis added) Adoption of the UAW proposal would undermine these efforts.

2. An Example for Others

No other developed country except Australia, New Zealand, and Spain, and no country that participates in producing for the world auto market, has local content requirements for automobiles.***/ U.S. adoption of such measures might easily lead to the adoption of similar measures, or other protectionist actions, by leading U.S. trade partners. This danger was emphasized by the CRS study, which noted that "retaliation against U.S. exports by countries affected could also nullify any gains in both the balance of trade and employment."****/ To underscore this concern, the CRS study repeated the following statement by Senator John Heinz:

> "The intrinsic problem with local content requirements is that they become a two-edged sword. If we have them, they are likely to be applied to our exports. If there are preferable alternatives (to local content requirements), we

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*/ Speech to International Insurance Advisory Council, May 19, 1981.

**/ Secretary of State Haig in testimony before the Subcommittee on International Trade of the Senate Finance Committee, July 28, 1981.

***/ Subcommittee on Trade, Hearings at 32.

****/ CRS Study at 14.

should adopt them, because the list of countries imposing very stiff local content requirements is growing daily and it is costing us jobs."*/

3. An Invitation to Other Industries

Finally, direct legislation to protect the automobile industry, such as the UAW is proposing, would lead to a flood of requests by other U.S. industries for legislated protection. During the past fifty years, the Congress rarely has legislated specific trade barriers for industrial sectors. To do so now would undermine the integrity of the U.S. laws that the Congress has enacted to deal with excessive or unfair trade competition, such as the "escape clause" provisions in section 201 of the Trade Act of 1974, the U.S. antidumping and countervailing duty laws, and section 301 of the Trade Act of 1974. It is not in the interest of the Congress to undermine the statutory schemes that it has developed largely for the purpose of deflecting direct political pressures for the erection of trade barriers, and to invite such pressures through the enactment of this misguided proposal.

B. Local Content Requirements Would be Inefficient, Costly, and Inflationary

1. The Same Effect as Quotas

The local content requirements that are being proposed by the UAW would operate like quotas. It probably would be

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*/ Ibid, citing Bureau of National Affairs, "Trade Policy: Heinz Cites Need for Tough Stance on Trade Reciprocity, Considers Section 201 Bill," U.S. Import Weekly, August 5, 1981 at A-22.

necessary to impose formal import quotas in order to enforce the limits of 200,000 and 500,000 units per year for manufacturers that did not utilize the requisite "North American content." Even if some other means of enforcement (such as fines) were used, the effect would be similar to a quota because in most cases manufacturers that did not meet the "North American content" requirements would voluntarily limit their sales in the U.S. market. Thus the UAW proposal would have the same effect as an import quota of 1.52 million units from all sources, based on 1980 sales volumes.*/ This is much more restrictive than the "voluntary" export restraint by the Japanese that is now in effect. Moreover, the local content requirements of the UAW proposal presumably would be permanent in order to provide incentives for investment in the U.S. market. Thus the negative effects would cumulate over time.**/

2. Direct Inflationary Effects

Even if the content requirements led to additional production facilities within the U.S., inefficiency and inflationary cost increases would result. The direct measure would be the additional cost of U.S. production as compared to the importing of autos, with appropriate adjustment for quality

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*/ Calculated by holding Toyota, Datsun and Honda to 200,000 units each, and assuming no additional exports from unrestrained suppliers.

**/ Further inefficiency would result as import demand would be diverted to marginal suppliers, and as foreign producers upgrade their product composition within the quantitative limit.

differences. If these costs were negligible, then the content legislation would be unnecessary.

The CRS study points out that part of this cost differential is attributable to higher wages in the United States, part to lower U.S. labor productivity, and part to other cost disadvantages.*/ The CRS study concludes that U.S.-produced automobiles cannot be price competitive with Japanese automobiles without some major cost-cutting by U.S. firms, and that "one way to lower costs is to procure more original equipment abroad":

> ". . . [O]ne auto industry analyst stated that if local content requirements were imposed in 1981, some U.S. companies, such as Ford and Chrysler, would not have the money to tool up to build the components they now import. Chrysler buys engines from Japan and Germany and will buy them from France. Chrysler would have been unable to produce K-cars in the volume currently existing, if it had not procured the engines from abroad."**/

The CRS study concluded flatly that "local content requirements would harm U.S. automakers directly."***/

3. Indirect Costs

The UAW proposal would isolate the U.S. market from international competition. This would encourage oligopolistic pricing practices in the U.S. market by U.S. firms and by foreign

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*/ CRS Study, p. 14, citing David W. Evans, "'Foreign Sourcing' Evident in U.S. Automobile Parts," Congressional Record, May 20, 1981 at E2472-73.

**/ Id. at 15, citing testimony by James Harbour in House Committee on Banking, Finance, and Urban Affairs, Subcommittee on Economic Stabilization, "To Determine the Impact of Foreign Sourcing on Industry and Communities," April 24, 1981.

***/ Id. at 14.

producers attempted to recoup their U.S. investments. The absence of effective international competition would, moreover, permit the UAW to continue to extract wages far in excess of the average for all manufacturing. Currently, wages in the auto sector are 28 percent above the average of all manufacturers.*/

An indication of what the UAW proposal would cost consumers can be gained by recalling estimates of the costs of quotas that were made by the Council of Economic Advisors, the Federal Trade Commission, and by Professors Pearson and Takacs for presentation to the International Trade Commission.**/

According to these studies the estimated annual cost to consumers per auto worker reemployed range from $245,000 to $1,125,000. The cost to consumers includes the revenue transferred to the domestic industry. The estimated annual net loss to the U.S. economy, which is somewhat lower, places the cost per auto worker reemployed in a range from $8,600 to $67,952.

In addition, the CRS study concluded that "the bookkeeping required to certify local content would likely impose major costs on automakers and suppliers":

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*/ USITC Publication 1110, December, 1980, at A-41.

**/ "CEA Calculations of the Impact of the Economy of a Japanese Automobile Restraint" Hearings before the Subcommittee on Economic Stabilization of the Committee on Banking, Housing and Urban Affairs, United States Senate, April 3, 1980; "Comments of the Staff of the Federal Trade Commission before the International Trade Commission," October 6, 1980; C. Pearson, "Certain Motor Vehicles and Certain Chassis and Bodies Therefor," Brief of the American International Automobile Dealers Association before the USITC, October 1, 1980.

"Complete records would have to be kept on each part entering into the manufacture of a vehicle. Most vehicles probably could not have their local content certified in the prototype state at the same time as their emissions and safety certification, because high-volume models are manufactured at different plants in the United States and often will have different sources for the same equipment. Some suppliers, moreover, change during the model year.

"Not only the final manufacturer but the supplier might be required to keep track of the local content of his product. Otherwise, automakers could "launder" imported parts through domestic suppliers. Going a step further, not only domestic auto suppliers, but the suppliers of the auto suppliers also use imported materials in their production process. Separating domestic and foreign content and recording it at each level of production would be an extremely costly operation.*/

C. Domestic Content Requirements are Unnecessary and Contrary to the Longer Run Interests of the U.S. Auto Industry

1. Problems Other Than Imports

In November, 1980, the International Trade Commission determined that imports were not a substantial cause or threat of serious injury to the U.S. auto industry. Instead, the Commission found that recession, high interest rates, and the shift in consumer demand toward small fuel efficient cars as a result of the increase in fuel prices were the principal causes of Detroit's distress.**/ Local content requirements would be completely irrelevant to these problems.

Moreover, the International Trade Commission found that import restrictions were not necessary for domestic restructuring

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*/ CRS Study at 17-18.

**/ USITC Publication 1110, December, 1980.

of the U.S. auto industry. Commissioner Stern was explicit on this point: "The plans underway for restructuring the industry address many of the industry's problems and do not depend in any demonstrable fashion on import relief.*/ It follows that further restriction of imports, beyond that accomplished by the VER, would not address the short or longer run problems of the industry, nor contribute to their solution.

2. Solutions Already in Progress

Detroit is already restructuring its product line to meet consumer demands. A recent Transportation Department Study projects that average fuel economy for U.S. built cars will increase from 18.6 mpg in 1978 to 31.0 mpg in 1985; that small cars will move from 37 percent of U.S. production in 1978 to 67 percent in 1985, and that the present proportion of U.S. cars with 4 cylinders will increase from 10 percent in 1978 to 62 percent in 1985.**/ The House Ways and Means Subcommittee on International Trade estimates that U.S. capacity to produce small, fuel efficient cars will increase from 1.75 million in 1980 to 4.0 million in 1982, and to 11.1 million in 1985.***/

This conversion is proceeding without local content requirements. It was given a boost with the VER arrangement

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*/ USITC Publication 1110 at 151.

**/ U.S. Department of Transportation, The U.S. Automobile Industry, 1980, January, 1981.

***/ House Committee on Ways and Means, Subcommittee on Trade, Auto Situation: 1980.

that will generate additional revenues for U.S. automakers. And it has been further supported by regulatory reforms undertaken by the Reagan Administration and the very significant tax reductions that have recently been enacted. In short, domestic content legislation is not needed to support conversion of U.S. plants toward small, fuel-efficient autos.

3. Local Content Requirements Counterproductive

Local content regulations enacted now might well be harmful for three reasons. First, in the unlikely event that the measure led to a massive transfer of auto production from abroad to the United States, it could create an enormous expansion of U.S. small car capacity. Thus U.S. producers would then face strong competition in the domestic market from foreign firms physically producing in the U.S., as well as substantial continued competition from imports remaining at or below the 200,000 per firm level.*/ The result of that competition might well discourage G.M., Ford, and Chrysler from completing their conversion, leaving them in a still weaker international competitive position.

Second, local content requirements would severely penalize foreign firms, such as Volkswagen, Honda and Nissan, which have or are establishing production facilities in the United States. Volkswagen produced 177,000 vehicles in the U.S. in 1980, but

*/ Additionally, establishing foreign facilities in the U.S. would aggravate an already critical bottleneck in the machine tool industry, hampering conversion by U.S. firms. USITC Publication 1110 at 161.

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required approximately 91,000 imported vehicles to round out its product line. A local content requirement of 75 percent would be virtually impossible to achieve, especially if imported parts and components are accounted for. Honda is in the same position. Its new U.S. assembly plant requires substantial imports, and it is critical to import additional models to fill in a complete product line. Similarly, Nissan's new facility for producing light trucks in Nashville, Tennessee, will depend heavily upon imported components. Commissioner Stern concluded that a remedy based on domestic content would in fact discourage foreign investment, basing her conclusion on confidential submissions from Volkswagen and Honda.*/

Third, local content requirements would adversely affect U.S. producers' prospects in the emerging world car industry. All five U.S. producers (including Volkswagen) currently import automobiles and/or small pickup trucks. For example, GM imports a small pickup from Isuzu (in which it has 34 percent ownership), and has in the past imported the Opel from Japan and Germany. Ford imports Courier trucks from Toyo Kogyo of Japan (25 percent ownership). Chrysler imports two trucks and two autos from Mitsubishi (15 percent ownership). AMC imports two autos from Renault, which controls AMC.**/

Trade in parts and components by domestic manufacturers is also substantial. Table 4.8, prepared by the U.S. Department

*/ USITC Publication 1110, at 162.

**/ USITC Publication 1110 at 165. See also CRS Study at 14-15.

Table 4.8

FOREIGN SOURCING - RECENTLY-ANNOUNCED COMMITMENTS BY U.S. AUTOMOBILE MANUFACTURERS TO PURCHASE FOREIGN-MADE COMPONENTS FOR USE IN DOMESTIC VEHICLES PRODUCTION

Automobile Manufacturer	Description of Component	Intended Use	Manufacturing Source	Approximate Number of Components	Period
G.M.	2.8 liter V-6	Cars	GM de Mexico	<400,000/year	1982-
	2.0 liter L-4 with transmission	Mini trucks	Isuzu (Japan)	100,000/year	1981-
	1.8 liter diesel L-4	Chevette	Isuzu (Japan)	small numbers	1982-
	1.8 liter L-4	J-car	GM de Brazil	250,000/year	1979-
	THM 180 automatic transmission	Chevette	GM Strasbourg (France)	~250,000/year	1979-
Ford	2.2 liter L-4	Cars	Ford-Mexico	<400,000/year	1983-
	Diesel L-4	Cars	Toyo Kogyo	150,000/year	1983-
	2.0 liter L-4	Mini trucks	Toyo Kogyo	<100,000/year	1982-
	2.3 liter L-4	Cars	Ford de Brazil	~50,000/year	1979-
	Diesel 6 cyl.	Cars	BMW/Steyr	100,000/year	1983-
	Turbo-diesel/4 cyl.	Cars	BMW/Steyer	-	1985-
	Manual transaxles	Front Disc Cars	Toyo Kogyo	100,000/year	1980-
	Aluminum Cylinder heads	1.6 liter L-4	Europe, Mexico	-	1980-
	Electronic Engine control devices	Cars	Toshiba	100,000+/year	1978-
	Ball Joints	Cars	Musashi Seimibu	1,000,000/year	1980-1984
Chrysler	L-6 and V-8 engines	cars	Chrysler de Mexico	<100,000/year	early 1970's
	2.2 Liter L-4	K-body	Chrysler de Mexico	<270,000/year	1981
	2.6 Liter L-4	K-body	Mitsubishi	1 Million	1981-85
	1.7 Liter L-4	L-body (Omni)	Volkswagen	1.2 Million	1978-82
	1.6 Liter L-4	L-body	Talbot (Peugeot)	400,000 total	1982-84
	2.0 Liter Diesel V-6	K-body	Peugeot	100,000/year	1982-
	1.4 Liter L-4	A-body (Omni replacement)	Mitsubishi	300,000/year	1984-
	Aluminum Cylinder Heads	2.2 liter L-4	Fiat		
AMC	Car components and power train	AMC-Renault	Renault in France and Mexico	300,000/year	1982-
VW of America	Radiators, Stampings	Rabbit	VW de Mexico	250,000/year	1979-
	L-4 diesel and gas	Cars	VW de Mexico	300,000 +/year	1982-

SOURCES: Compiled from Automotive News, Ward's Engine Update, Ward's Automotive Report, American Metal Market, Detroit Free Press, and Japan Economic Journal.

of Transportation, provides a description of U.S. producers' imports of engines, transaxles, ball joints, cylinder heads and other components.

Domestic content legislation would be a step in the wrong direction as far as solving the domestic auto industry's principal problem - its inability to produce cars of equal quality to imports at equal cost. Domestic content rules would make domestic automobile production even more costly than it is today, exacerbating the non-competitive posture of U.S. auto makers.

While differences in labor costs between U.S. and Japanese-made automobiles are largely offset by transportation expenses, there remains a cost difference estimated at approximately $1,000 due to higher Japanese productivity, more efficient supply systems and better management techniques. Imposing domestic content requirements on U.S. manufacturers would insulate U.S. labor from foreign competition by limiting use of imported components, and guarantee a permanent cost disadvantage for U.S. auto companies.

The resulting isolation would rule out any possibility that domestic companies could become competitive in world markets, where much of all future automobile sales growth will occur.

By general consensus, internationalization of auto production is the wave of the future, and U.S. firms must participate in order to survive in the global car market. Dr. Marina Whitman, Chief Economist for General Motors, has stated: "An open trading environment also serves the long-term interests of major U.S. producers - including auto producers - which need open trade to rationalize their production on a global basis. U.S.-based multinational firms would be adversely affected both by domestic trade barriers that hinder the flow of parts and components in a global industry, and by foreign retaliation that could restrict access to markets abroad."*/ Commissioner Stern, in considering import barriers, argues that GM, AMC, Chrysler, and Ford may be made worse off by import relief in the U.S. market. "Furthermore, there are good reasons to believe that relief would be inimical to the interests of most other producers [i.e., GM, Ford, AMC, Chrysler], because they have already become so highly integrated on an international scale.**/

In summary, U.S. auto firms are inextricably bound to the international auto market in terms of financing, profit generation, imported models, imported parts and components, and

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*/ Challenge, May/June 1981 at 42.

**/ USITC Publication 1110 at 163.

global production and distribution. They might not survive a measure that would cleave U.S. production from the international market place, and contribute to fragmentation of the remaining market.

III. Effect of UAW Proposal Upon U.S. International Obligations

A. The Proposals Would Cause the United States to Violate Its Obligations Under the Most-Favored Nation Provisions in Article I of the GATT

The UAW proposes to count both Canadian and U.S. components for purposes of establishing "North American content." This would violate U.S. obligations under the most-favored nation (MFN) provisions of the GATT in two ways.

First, the quotas of 500,000 and 200,000 units per year would not apply to manufacturers using primarily Canadian content. For example, a manufacturer that used 91 percent Canadian content, or 51 percent Canadian and 40 percent U.S. content, would escape the quota that would be applied to a manufacturer that used the same proportions of Japanese or Italian content. Similarly, a manufacturer using 75-90 percent Canadian content (or U.S. and Canadian content in combination) would be able to sell between 200,000 and 500,000 automobiles per year in the United States; but a manufacturer that used the same proportions of French or British content would not be allowed to sell more than 200,000 units annually in the United

States. This would constitute blatantly discriminatory preferential treatment of "Canadian" products as compared with the treatment accorded to products of other nations.

Second, the proposal would violate U.S. MFN obligations under the GATT because it would strongly encourage automobile manufacturers around the world to purchase Canadian components. Both this incentive for the purchase of Canadian products and the exemption of "Canadian" manufacturers from the proposed quotas would violate directly the MFN obligations of the United States that are set forth in Article I(1) of the GATT, which states:

> "With respect to customs, duties and charges of any kind imposed on or in connection with importation or exportation. . . <u>and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraph 2 and 4 of Article III,*/ any advantage, favor, privilege or immunity</u> granted by any contracting party to

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*/ Paragraph 4 of Article III states in pertinent part as follows:

> "4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favorable than that accorded to like products of national origin in respect to <u>all laws, regulations, and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use</u>." (emphasis added)

Because Article I incorporates by reference Article III(4), the most-favored nation obligation set forth in Article I encompasses those activities that are listed in Article III(4), i.e., "laws, regulations, and requirements affecting. . . internal sale, offering for sale, purchase, transportation, distribution or use."

> any product originating in or destined for any other contracting party shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties." (emphasis added)

Certainly the counting of Canadian components in determining "North American content" for purposes of applying the quotas proposed by the UAW would be an "advantage, favor, privilege, or immunity" conferred upon products originating in Canada with respect to ". . . rules and formalities in connection with importation and exportation. . . " and with respect to "requirements affecting. . . internal sale. . . " That "advantage, favor, privilege, or immunity" would be denied to the products of other nations. In addition, the artificial incentive that the proposals would provide for the purchase of Canadian products would be a special "advantage, favor [and] privilege" with respect to U.S. requirements affecting internal sale.

These violations of U.S. MFN obligations would not be covered by the waiver that the GATT contracting parties granted to the United States and Canada on December 20, 1965,*/ in order to permit those countries to carry out the U.S.-Canadian Automotive Products Agreement. This waiver was not a blank check for the United States to grant any future preferential treatment to Canadian automotive products. The waiver, in fact, only permitted the United States and Canada to eliminate then-existing

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*/ [1966] 1 U.S.T. 1372, T.I.A.S. No. 6093 (entered into force provisionally, Jan. 16, 1965, and definitively, Sept. 16, 1966).

tariffs on their bilateral trade in certain automotive products, without extending such duty free treatment to automotive products of other nations. The operative paragraph of the GATT waiver that was granted to the United States provides as follows:

> "The Government of the United States, notwithstanding the provisions of paragraph 1 of Article I of the General Agreement, is free to eliminate the customs duties at present imposed on automotive products of Canada without being required to extend the same tariff treatment to like products of any other contracting party."*/

The following excerpt from the preamble to this waiver underscores the intention of the GATT contracting parties that the waiver was to be limited to scope and was to cover only the elimination of tariffs:

> "Considering, moreover, that the Government of the United States accepts that the facilities granted in paragraph 1 below should not be used in a way to prejudice the interests of other contracting parties and that it is not its intention to cause imports into the United States market of automotive products imported from other sources. . . "**/ (emphasis added)

Because this waiver does not cover the favorable treatment that would be accorded to Canadian products under the UAW proposal, the proposal would cause the United States to be in

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*/ General Agreement on Tariffs and Trade, Basic Instruments and Selected Documents, 14th Supp. at 37.

**/ Id. at 38.

violation of its obligations under Article I of the GATT.*/ The consequences of this violation are discussed in Section 6 below.

B. The "North American Content" Provisions Proposed by the UAW Constitute Internal "Mixing Requirements," Which are Prohibited by Article III(5) of the GATT**/

Article III(5) of the GATT states as follows:

> "No contracting party shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulations must be supplied from domestic sources. Moreover, no contracting party shall otherwise apply internal quantitative regulations in a manner contrary to the principle set forth in paragraph 1. (emphasis added)

. . . .

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*/ Vice Chairman Michael J. Calhoun reached essentially the same conclusion in his opinion accompanying the report of the U.S. International Trade Commission on Certain Motor Vehicles and Certain Chassis and Bodies: "the waiver granted by the contracting parties to the United States for its discriminatory implementation of the Autopact was clearly a waiver of the obligations concerning customs treatment imposed upon the United States under Article I:1 of the General Agreement. The contracting parties seemed to consider the Autopact to be limited to tariff treatment. No mention was made of Article XXIV (relating to customs unions and free-trade areas). The preamble to the waiver and the waiver itself repeatedly referred to 'duty free treatment' and 'customs duties.' Further reading leads to the conclusion that the waiver was granted to further the international rationalization of production, provided the rights of other contracting parties are protected." (USITC publication 1110,

Footnote continued on next page

**/ The CRS Study also reached this conclusion. CRS Study at 10.

Paragraph 1 asserts, in pertinent part, that

> "[t]he contracting parties recognize that . . . laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production." (emphasis added)

These provisions prohibit, among other things, "mixing requirements," which are a device for protecting domestic production by requiring that imports or domestic sales of a particular product contain a specified proportion of local content. The "North American content" requirements that are being proposed by the UAW are precisely such devices. Insofar as the proposal would require the use of high proportions of U.S. content in imported automobiles, it would directly conflict with Articles III(5) and II(1) of the GATT, which are quoted above. Insofar as the proposal would require or permit the use of Canadian content in automobiles that are imported into the United States, it would directly conflict with the Article III(7) of the GATT, which states as follows:

> "No internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions shall be applied to such a manner as to allocate any such amount or proportion among external sources of supply."

Footnote continued from previous page

December 1980 at 46-47). Agreement with this view is strongly implied in the opinions of USITC Chairman Bill Alberger and Commissioner Paula Stern, who together with Vice Chairman Calhoun comprised the majority of the Commission in the automobile case. (Id. at 13 and 101-103.)

The consequences of violating U.S. obligations under Article III of the GATT also are discussed in Section D below.

C. The Proposal Would Require the United States to Violate Its Obligations in Article XI of the GATT Not to Impose Quotas or Quantitative Restrictions Upon Imports Except in Carefully Limited Circumstances*/

As was described above, the proposal probably would require the application of import quotas to automobile manufacturers on the basis of the proportion of "North American content" in the manufacturer's fleets.

Such import quotas are flatly prohibited by Article XI(1) of the GATT, which states:

> "No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses, or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party. . . " (emphasis added)

There are certain exceptions to this prohibition upon the use of quotas and quota-like restrictions, but none of these exceptions would cover the local content requirements and accompanying quotas that are called for by the UAW proposal.

Quotas that fall within the exceptions (and thus, unlike those proposed by the UAW, are permissible) are required by Article XIII of the GATT to be administered on a nondiscriminatory basis. The operative paragraph of Article XIII states as follows:

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*/ The CRS Study also reached this conclusion. CRS Study at 10.

> "No prohibition or restriction shall be applied by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation of any product destined for the territory of any other contracting party, <u>unless the importation of the like product of all third countries</u> or the exportation of the like product to all third countries <u>is similarly prohibited or restricted</u>." (emphasis added)

The preferential treatment that the proposal would accord to Canadian manufacturers of vehicles and parts would contravene directly this provision. Thus not only would the proposal necessitate the use of quotas that are prohibited by GATT Article XI, but also it would require the use of discriminatory quotas in further violation of the GATT Article XIII.

D. <u>The Proposal Would Constitute a Nullification or Impairment of Benefits Accruing to Other GATT Contracting Parties and Thus Would be Successfully Challenged Under Article XXIII of the GATT</u>

Article XXIII of the GATT permits contracting parties to initiate formal complaint proceedings whenever any direct or indirect benefit to the complaining party under the GATT is being "nullified or impaired" as a result of:

> "(a) the failure of another contracting party to carry out its obligations under [the] agreement, or
>
> (b) the application by another contracting party of any measure, whether or not it conflicts with the provisions of the agreement, or
>
> (c) the existence of any other situation . . . "

These broad criteria would permit contracting parties that would be affected by the UAW proposal, principally Japan and the European Communities, to bring formal GATT complaints against the United States both on the ground that the proposal specifically violated several U.S. obligations under the GATT, and on the ground that the proposal "nullified or impaired" GATT benefits to those countries regardless of whether the proposal violated a specific GATT obligation of the United States.

As a result of such challenges, the GATT would form a panel of 3-5 experts to receive documents and to hear arguments of all parties and to issue a determination with respect to the U.S. practice. There can be no reasonable doubt that a GATT panel would find the UAW proposal to be in violation of several U.S. obligations under the GATT, as described above, and would also find that the proposals nullified or impaired GATT benefits to other contracting parties. Specifically, the benefit that would be nullified or impaired would be the reasonable expectation of other contracting parties that the U.S. import duty rate for automobiles, which was "bound" (or guaranteed) at 2.9 percent for 1981 with a gradual reduction to 2.5 percent by 1987, was undermined by the imposition of the "North American content" requirements and quotas necessary to enforce those requirements. It would not be difficult to show that the trade of Japan and the EC had been adversely affected by the proposal.

As a result of such a finding, the GATT panel or its parent body, the GATT Council, might recommend that the United States repeal the UAW proposal. Failure to act upon such a recommendation could result in retaliation by Japan and the EC in the form of import restrictions upon such U.S. exports as agricultural products, agricultural and mining equipment, and power-generation equipment, office machines, computers, semiconductors and integrated circuits, telecommunications equipment, and aircraft. Because the proposal would affect billions of dollars worth of non-Canadian exports to the United States, retaliation against the United States could be expected to affect billions of dollars worth of U.S. exports.

Even if retaliation were not formally authorized and implemented for several years following a finding by a GATT panel, the dispute resulting from the unsatisfied panel finding would be an enormous irritant in U.S. economic relations with its major trade partners and a symbol of U.S. protectionism that would strongly encourage trade-restrictive actions by other nations.

E. The Proposal Would Require Renegotiation of the U.S.-Canadian Agreement Concerning Automotive Products

The U.S.-Canadian Automotive Agreement also contains a local content provision. Annex B of the Agreement provides that, in order to be considered "Canadian" products and thus to be eligible for duty-free entry into the United States, automotive products from Canada must not have more than 50 percent foreign (i.e., non-Canadian or non-U.S.) content. The UAW proposal would make a nullity of that provision by effectively requiring automobiles imported from Canada to have at least 75 percent U.S. or Canadian content if the manufacturer sold more than 200,000 units annually in the U.S. market, or at least 90 percent U.S. or Canadian content if the manufacturer sold more than 500,000 units annually in the United States.*/

F. The Proposal Would Violate Provisions of the U.S.-Japan Treaty of Friendship, Commerce, and Navigation

The UAW proposal would violate provisions of the U.S.-Japan Treaty of Friendship, Commerce, and Navigation.**/ That treaty, which has been in effect since 1953, specifies the following rules with respect to MFN and national treatment:

Article XIV

> "1. Each Party shall accord most-favored nation treatment to products of the other Party, . . . with respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation.

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*/ This point also was noted in the CRS Study. CRS Study at 8-9.

**/ T.I.A.S. 2863.

Article XVI

> "1. Products of either Party shall be accorded within the territories of the other Party, national treatment and most-favored nation treatment in all matters affecting internal taxation, sale, distribution, storage and use."

As is discussed above, the UAW proposal would violate the MFN principle in at least two ways: first, by treating Canadian automobiles more favorably than other foreign automobiles with respect to requirements for entry into the U.S. market; and second, by encouraging the sale of Canadian components around the world. The MFN principle that is set forth in the U.S.-Japan Treaty of Friendship, Commerce, and Navigation is essentially the same as the MFN principle that is expressed in Article I of the GATT.

IV. Conclusion

As is demonstrated above, the UAW proposal to apply "North American content" requirements to automobile manufacturers with substantial sales in the U.S. market would be unnecessary and ineffective in helping the U.S. auto industry, and would be a disastrous trade policy measure. The proposal would cause the United States to violate several of its international obligations, and would provoke trade retaliation by foreign governments against U.S. exports. In short, this is a special relief proposal that would be of dubious benefit to UAW members in the United States and Canada, but that would do great harm to U.S. automobile companies, U.S. consumers, other U.S. industries and their workers, the U.S. economy as a whole, and U.S. international economic relations.

Mr. McELWAINE. Thank you, sir.

I would like to yield to Mr. Connelly.

Mr. CONNELLY. Mr. Chairman, may I make a few remarks?

Senator DANFORTH. The hope was to go through the list with approximately 5 minutes per witness. It was my understanding that on this panel, Mr. McElwaine and Mr. Millet were to testify.

You may make a few remarks, but if you could keep it short, I would really appreciate it.

Mr. CONNELLY. Thank you, Mr. Chairman.

I am an automobile dealer, and I look at a lot of the questions that have come up today from a little different point of view.

First of all, I would like to say that, as you well know, since we have talked about it, I have been to Japan. I have also presented to the different manufacturers in Japan our ideas on manufacturing here in the United States.

Although I am sorry the Governor of Missouri only got a handshake the other day, in the State of Ohio, the Honda organization has already a motorcycle plant in production. Their automobile plant to produce Hondas is being completed right now, and I believe that they will be online next year.

I am also very happy to announce that tomorrow there will be a ground breaking in Marysville, Ohio, for a new parts plant, again by the Honda organization. So I do feel as though something is being accomplished in that particular line. It is one of our goals.

The second comment that I would like to make refers to a statement that the UAW spokesman made when he was questioning if a reduction to 1.68 million imports was low enough, and perhaps it should have been 1.2 million.

I don't know that there is any reason to believe that even a 1.2 million limitation would have sold one more American car. What I do know is that 1.68 million limitation hurts individual dealers, and we now cannot increase our sales, we are limited. The 1.68 million does hurt, believe me, and a 1.2 million figure would have put most of us out of business.

One other comment I would like to make, and then I will end with this, and it concerns Senator Chafee's question, why do people still continue to demand, ask for, and buy Japanese cars, is it price or is it quality?

I don't suppose I know the answer any more than anyone else did, but I do know this. There is a great variety of import cars, there are all sorts of models, and they appeal to many, many different attitudes toward driving. At the same time, I am seeing Detroit going to a sameness.

Just as I am on the showroom floor talking to customers, I am beginning to wonder again if maybe this sameness, or maybe this idea that General Motors and/or Ford, and/or Chrysler, or the UAW know better, isn't being resented by the American buying public.

Thank you, Senator.

Senator DANFORTH. Thank you.

Mr. Millet.

STATEMENT OF RALPH T. MILLET, CHAIRMAN OF THE BOARD, AUTOMOBILE IMPORTERS OF AMERICA, INC., ARLINGTON, VA.

Mr. MILLET. Thank you, Mr. Chairman.

I appreciate the opportunity to appear before you. My prepared remarks today were limited to the proposal, emanating primarily from the UAW for local content legislation. However, since the UAW only briefly raised that subject today, I would like to submit for the record at this point a copy of our prepared statement on that proposal.

[The prepared statement follows:]

STATEMENT OF
RALPH T. MILLET, CHAIRMAN
AUTOMOBILE IMPORTERS OF AMERICA, INC.

Mr. Chairman and members of the committee, I am Ralph T. Millet, Chairman of the Automobile Importers of America, Inc. (AIA), and representative for Saab-Scania. Accompanying me is David Busby of the firm of Busby, Rehm and Leonard. AIA is the association of major automobile importers in the United States. A list of AIA members is attached.

I will limit my prepared remarks today to proposals emanating primarily from the United Auto Workers (UAW) for local content legislation. As you know, such legislation would require a car sold in the United States in large volumes to contain a certain percentage of U.S. parts and labor. As we look at the strategies of all four Detroit companies -- as well as those of most major foreign producers -- we are struck by the critical hardship such legislation would impose upon manufacturers and consumers in the United States as well as those outside the United States. The Detroit companies would be the biggest losers. They have staked their future on the development of a world car. The fundamental prerequisite of this concept is the free flow of parts. Local content legislation moves in the opposite direction.

Local Content Legislation Would Hurt U.S. Companies

Dr. Marina Whitman, Chief Economist for General Motors, discussed in July of this year the response of U.S.-based producers to the "changed competitive environment." She said:

> ... the most relevant strategies of adaptation to competition are the development of the 'world car' concept and the creation of a production base for worldwide sourcing of components. Under the 'world car' concept, automobiles little differentiated in size and design among different geographic areas are assembled from parts and components that are to a large extent standardized and interchangeable.*

In an earlier article opposing local content requirements, Dr. Whitman stated:

> An open trading environment also serves the long-term interests of major U.S. producers -- including auto producers -- which need open trade to rationalize their production on a global basis. U.S.-based multinational firms would be adversely affected by domestic trade barriers that hinder the flow of parts and components in a global industry, and by foreign retaliation that could restrict access to markets abroad.**

A Congressional Research Service Report of August 20, 1981,*** summarized:

> U.S. automobile producers (unlike workers) could be harmed by local content regulations .... Any constraints imposed on an automaker's ability to reduce costs will hamper its ability to compete both at home and abroad.
>
> Local content requirements would tend to push up prices for both foreign and domestic automobiles mainly because of higher costs of production in the U.S. (except when compared to Europe) but also because of tariffs, import quotas or fines necessary to enforce a local content provision. Higher automobile prices could cut into demand and offset some gains in employment.

* ESSAYS IN INTERNATIONAL FINANCE, No. 143, July 1981. International Finance Section, Department of Economics, Princeton University, Princeton, New Jersey.

** CHALLENGE, May/June 1981, at 42.

*** Congressional Research Service, "Local Content Laws and Automobile Imports: Arguments Pro and Con."

In addition to contravening and frustrating the enormously expensive industrial strategies the U.S.-based companies have embarked upon for the restoration of their health, local content proposals are misguided for the following reasons:

1. Local content legislation would be contrary to, and would undermine, the market economy policy of the Administration;

2. Local content legislation would violate the international obligations of the United States; and

3. Local content legislation would increase the cost of automotive products to purchasers.

The Administration Opposes Local Content Legislation

At the recent hearings on U.S. trade policy before the Trade Subcommittee of the House Ways and Means Committee, Administration witnesses repeatedly opposed performance requirements, such as local content legislation, both here and abroad.

U.S. Trade Representative William Brock reviewed the current efforts being made by the United States through the OECD, the GATT, and the IMF/IBRD toward the elimination of performance requirements throughout the world. He stated:

> Our objective is to obtain a consensus on the rules to restrict the imposition of performance requirements.

Obviously, if Congress were to pass local content legislation, it would not only contradict Administration policy, but undermine its efforts to eliminate performance requirements in other countries.

Under Secretary of Commerce Lionel Olmer at the same hearings stated:

> Artificial requirements such as local content and export targets ... can distort trade and investment as much as traditional tariffs and quotas.

Local Content Legislation Would Violate Our International Obligations

At the same hearings, Harvey E. Bale, Jr., Assistant U.S. Trade Representative for Investment Policy, stated:

> Local content and import substitution requirements divert purchases of foreign-owned firms away from sometimes preferred foreign suppliers toward local producers. These local content restrictions are, as witnesses in previous hearings have argued, the fundamental equivalent of quotas which ... run counter to the G.A.T.T.

Undoubtedly one of the provisions to which Mr. Bale referred was Article III, paragraph 5, of the G.A.T.T. which states:

> No contracting party shall establish or maintain any internal quantitative regulation relating to the mixture, processing, or use of products in specified amounts or proportions which requires ... that any specified amount or proportion ... must be supplied from domestic sources.

At present, no country which produces automobiles for the world market maintains such local content requirements. As noted by the Congressional Research Service such countries as Australia and Spain maintain local content requirements affecting automobiles. The Subcommittee on Trade of the House Ways and Means Committee listed in its Report entitled "Auto Situation: 1980" the countries having local content requirements.* None of these produce automotive products for the world market. Most are underdeveloped. Surely the United States is not willing to join the ranks of those countries who concede -- by the passage of local

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* "Auto Situation: 1980," Subcommittee on Trade of the House Committee on Ways and Means, at 93.

content legislation -- that its automotive industry cannot compete in world markets.

If the United States were to enact such legislation, it would violate the GATT and invite retaliation by passage of similar laws. This would result in the "Balkanization" of the world's automotive industry and would be detrimental to the interests of all involved, especially purchasers of automobiles.

Local Content Legislation Would Adversely Affect Purchasers

If local content legislation were enacted, the domestic industry's costs of production would increase as discussed above. The effect would necessarily be to increase the cost of vehicles to purchasers.

AIA believes that, rather than take actions which would harm the U.S. automotive industry and the American public, Congress should consider actions which would help the domestic industry <u>and</u> the public. AIA agrees with the conclusion of the Congressional Research Service Report:

> Some alternatives to local content legislation would be to assist the automotive supplier industries through general economic policies designed to raise the economic competitiveness of all U.S. industry, deregulation, attempting to eliminate local content laws in other countries, allowing more vertical and horizontal integration in the auto industry, and promoting sales of U.S. automotive supplies abroad and as replacement parts for imported cars in the United States.

Thank you. I will be happy to answer any questions.

Attachment

MEMBERS OF AUTOMOBILE IMPORTERS OF AMERICA, INC.

ALFA ROMEO

BMW

DE LOREAN

FIAT

HONDA

ISUZU

JAGUAR ROVER TRIUMPH

LOTUS

MAZDA

MITSUBISHI

NISSAN

PEUGEOT

ROLLS-ROYCE

SAAB-SCANIA

SUBARU

TOYOTA

VOLVO

Mr. MILLET. I might add that we feel very strongly that such legislation would impose very critical hardships upon manufacturers and consumers in this country, as well as those outside the United States. Local content legislation would cripple Detroit's efforts to build a world car, and the world car concept is one on which Detroit must rely for its survival.

Local content legislation would also contravene the market economy policy of this administration, as well as violate the international obligations of the United States. Needless to say, it would also increase the cost of the cars to the American public.

I had the privilege of appearing before you in January of this year, at which time I made a number of recommendations to assist the American automobile industry, and some of these steps have been implemented. But I might mention that it is very, very soon to evaluate the effect of those steps.

In addition to the financial assistance which was given to Chrysler, the other steps that have been taken include: (1) the tax reforms, which permit more rapid writeoffs and the sale of past losses; (2) the regulatory reforms, including the rescission of the passive restraint standard—and I certainly hope that there will be some effort to rescind or relax the automotive exhaust emission standards; (3) the Justice Department agreement that sanctions under the automobile industry consent decree be abandoned; (4) the Federal Trade Commission's dropping of the automobile industry investigation; (5) the rollback of the Japanese imports to 1.68 million through March 1982, and perhaps somewhat more, through March 1983.

Furthermore, there is a much better political climate today toward Detroit, which certainly should help to improve Detroit's future prospects.

I would like to reiterate my statement at the January 15 hearing: that the most effective actions that the Government should take to help the automobile industry are not costly measures that would be directed at this industry alone. Rather, the industry can be helped more through an overall approach directed toward creating a healthy business environment, one in which inflation is controlled, interest rates are sharply down, and the economy grows at a reasonable pace.

I think we have taken those steps, and I think we are on that road. I think we ought to give it a chance to work before we act hastily.

Thank you, Mr. Chairman.

Senator DANFORTH. Gentlemen, thank you very much.

The subcommittee stands adjourned.

[Whereupon, at 12:05 p.m., the subcommittee adjourned, subject to the call of the Chair.]

[By direction of the chairman the following communications were made a part of the hearing record:]

STATEMENT OF FORD MOTOR COMPANY
SUBMITTED TO THE SENATE FINANCE SUBCOMMITTEE ON
INTERNATIONAL TRADE

Ford Motor Company appreciates the continuing concern shown by this subcommittee regarding the state of the U.S. auto industry. When Ford testified last March, U.S. auto production was running at a 19-year low, and nearly 200,000 Ford, GM and Chrysler workers were on indefinite layoff. In the preceding 14 months, more than 2,200 domestic auto dealers and 137 supplier plants had closed their doors. Financial results for 1980 had just been released for U.S. auto producers, reporting a combined loss of $4.2 billion in world-wide earnings for the industry, staggering even the most bearish analysts.

Industry and economic analysts were forecasting that the industry's fortunes would improve considerably by year end or certainly in early 1982. As you know, these forecasts of improvement proved premature, to say the least.

- Domestic production of cars and trucks in 1981 has remained flat and is now projected at 8 million units, no improvement from 1980.
- Compared with the 1976-78 average, domestic car production is off 30%, to the lowest level in 20 years, and domestic trucks are down almost 50%.
- Some 180,000 seniority auto workers with recall rights remain on indefinite layoff, and the total would have been substantially larger if it did not exclude those who have been out of work so long as to lose their recall rights. Many tens of thousands of salaried employes have lost their jobs and white collar layoffs are increasing as the downturn persists.
- Another 600 domestic dealerships and 30 supplier plants have closed during 1981.

Unprecedentedly high interest rates have severely depressed U.S. retail demand for cars and trucks. There is no question that tough economic medicine was needed but the exceptionally stringent money policy has taken a disproportionately heavy toll in the auto and housing industries for quite some time. In fact, auto demand and consumer buying attitudes about buying cars have been depressed ever since the prime rose above 10% in 1979. Even with some recent moderation, interest rates are a continuing problem, both in terms of cost and in terms of the uncertainty about the future that fluctuating prime rates have on potential buyers. Now the rest of the country is beginning to experience the same depressed conditions the auto industry has been living with for more than two years, and this factor is further limiting auto demand.

In spite of these difficult conditions, Ford Motor Company can report some progress. An aggressive cost-reduction program has reduced costs by more than $2.5 billion on an annual, ongoing basis, and the company's product revolution continues on track. For example, beginning with the 1982 models, Ford will unveil ten new vehicles and six new engines in a 30-month period. Ford also has progressed in quality improvements, as evidenced in public enthusiasm for the Escort, the EXP, and the Mustang -- each of them sales leaders in their product classes. Warranty results and the actual experience of new vehicle owners demonstrate clearly that car and truck quality has improved 25% over 1980. Much of this improvement can be credited to the determination, performance and pride of our hourly employes and the cooperation of the UAW.

There has also been some progress from actions undertaken in Washington. For example, steps have been taken to mitigate the impact of regulation on costs and engineering resources. Moreover, the recently enacted tax bill produced some short-term help for Ford as well as a sounder long-term planning environment for all industry.

We all hope that the Administration's economic recovery program is on its way to accomplishing the goal of strengthening our economy; these efforts will, of course, take time to have an effective impact. In the meantime, we continue to face an extraordinarily difficult operating environment. The cash drain from U.S. auto operations has been massive as we have struggled to maintain planned spending on critical new product programs in spite of unprecedented losses. So the problems remain much the same as they were in March; we need more volume and vastly improved cost-price relationships.

Last March, it was generally accepted that the most effective short-term government policy that would help provide the U.S. auto industry with a bridge between these difficult economic times and recovery was to encourage voluntary restraint on the part of foreign producers. The results, however, have been disappointing.

When Japan's export restraint was announced it was expected that industry passenger car volume for the first 12-month restraint period would recover to some 10 million units. During the third quarter of

1981 (second quarter of restraint period), it appeared that restraints were beginning to have an effect. Car sales had increased to a 9.2 million annual rate and the Japanese share was down, suggesting that some shift to U.S. production and jobs was underway. Then the nation went into general economic recession, and car and truck demand collapsed. Because of this decline in total industry volume, it now appears that "restrained" Japanese car imports will permit the Japanese exports to take a somewhat larger share of the U.S. market this year than last year -- almost 22% this year, or more than 4 percentage points higher than the level that would have resulted had the 10 million unit forecast been achieved.

It is important to note that although the import restraint program has not accomplished the hoped-for benefits for U.S. producers, it has not posed the problems for American consumers that had been forecast by critics of restraint -- i.e., that there would be inflationary price increases and fewer fuel efficient vehicles for American consumers.

- The announced price increases of U.S. 1982 model cars were below the inflation rate.
- The fuel economy of the U.S. fleet is up -- in fact, domestic cars lead imports in 12 out of 16 weight classes.
- The Japanese improvement in market share has taken place in the smallest cars, which have registered a greater share improvement, year-over-year, than the Japanese average. And it is on these small cars that the Japanese producers have taken the smallest price increases.

As a result of the events outlined above, this year's U.S. deficit in automotive trade with Japan will be a staggering $13 billion, out of a total trade deficit of $15 billion for all products, an increase of $5 billion over 1980. Moreover, these monetary measures of imbalance substantially understate the employment imbalance because there are far more jobs per $1 billion of U.S. auto imports from Japan than there are in U.S. exports of commodities like feedgrains and logs to Japan. From our viewpoint then, the U.S./Japan auto problem that was the subject of this subcommittee review in March, 1981, remains unsolved.

HONDA
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December 8, 1981

The Honorable John C. Danforth
United States Senate
460 Russell Senate Office Building
Washington, D.C. 20510

Dear Senator Danforth:

American Honda Motor Co., Inc. is pleased to submit its views on the current status of U.S.-Japan automobile trade.

In November 1980, the U.S. International Trade Commission concluded that the problems the U.S. auto industry was undergoing were not caused by an increase of Japanese car sales in the U.S. In spite of this conclusion, the Japanese government decided in May 1981, as a demonstration of its political awareness and sensitivity towards the U.S., to institute a voluntary restraint on its passenger car exports to the U.S.

After the voluntary restraint was in place, U.S. car sales showed no improvement, proving that the voluntary restraint did not provide the type of relief necessary to turn the U.S. automobile industry around. This justifies the ITC's conclusion that there had been no causation between the U.S. industry's current problems and Japanese car sales in the U.S., nor was there any threat of injury. The restraint has resulted in an increase in car prices which has a negative impact on U.S. consumers.

During the past year, Honda has proceeded on schedule with its auto plant construction in Ohio, and in fact, has moved up its projected target of full capacity (150,000 units yearly) by six months to May 1984. Production will start in late 1982. The factory will employ 2,000. The plant represents an investment of over $200 million, an amount comparable to the rest of Honda's worldwide investments combined.

Additionally, Honda is continuing to expand its parts procurement from U.S. sources. For calendar 1981, Honda will:

Export to Japan	$ 68 million
and Use in the U.S.	37 million
for a Total Of	$105 million

Through these measures, Honda is contributing directly to the U.S. We practice internationalism, and have always looked outward from Japan. We believe such activities are beneficial to the economies of both the U.S. and Japan. We, therefore, oppose restrictive measures, such as local content requirements, because they are obstructive to these goals and detrimental to Honda's U.S. investment.

Sincerely,

Toni Harrington

Toni Harrington
Washington Representative

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