CENTER FOR TRADE POLICY STUDIES

Free Trade Bulletin

No. 22 • July 27, 2006

Blowing Exhaust: Detroit's Woes Belie a Healthy U.S. Auto Market

by Daniel Griswold, director, and Daniel Ikenson, associate director, Center for Trade Policy Studies, Cato Institute

Introduction

Recent news from the automotive capital of Detroit has been grim. General Motors and Ford, the two largest U.S. automobile companies, have lost billions of dollars on their North American operations in 2005 and 2006. Pinched between rising costs and declining market share, the two companies have announced that they will eliminate 60,000 jobs between them during the next several years. Either or both could face bankruptcy. Meanwhile, Delphi, a major parts manufacture and GM spin-off, filed for Chapter 11 late last year. The struggles of those companies have prompted headlines about the decline of the U.S. automobile industry and calls for Washington to come to its rescue.

Although complaints about unfair competition from abroad are less shrill than in the 1980s, foreign producers have not escaped criticism. The chief executive officers of General Motors and Chrysler recently complained that an allegedly undervalued yen gives vehicles imported from Japan an unfair price advantage of as much as $3,000 per vehicle.[1] Sen. Carl Levin, a Democrat from Michigan, charged at a hearing in February that Detroit-based automakers face unfair foreign competition. "They are competing with currency manipulation by other countries, including China, Japan and Korea, which gives their vehicles and other products an unfair price advantage in our market," Levin said in a statement.[2] And the United Auto Workers union, which represents workers at GM, Ford, Chrysler, and several parts' producers, has called for a federal "Marshall Plan" to aid those companies.[3]

Despite the news from Detroit, the U.S. automotive industry is healthy. Both domestic sales and output of cars and light trucks are at or near record levels. All of the top 10 selling models of cars and light trucks are produced at U.S. plants employing over one million Americans, which is the same level of industry employment as in the early 1990s. And several companies have announced plans to expand or build new production capacity in the United States beginning this year.

What has changed over the past few decades is the relative market share of each producer. Foreign nameplate producers have earned larger shares of the market—mostly through production at their U.S. facilities, but supplemented by modestly increasing imports—while GM, Ford, and the Chrysler division of DaimlerChrysler (the Big Three) have lost domestic market share. The reasons for these shifts are varied but have to do with decisions made at the individual company levels regarding product design, market focus, and the wages and benefits of their respective labor forces. The shifts have nothing to do with alleged unfair trade practices.

The financial woes of a few companies operating in a healthy, competitive market do not justify intervention by Washington policymakers but are the market's way of providing feedback about the decisions of those firms. It is not the role of the government to rescue companies that have made relatively bad decisions. Healthy competition ensures that best practices are emulated, leads to gains in productivity and innovation, and provides American automobile consumers with greater choice, better quality, and more competitive pricing.

A New and Improved U.S. Automobile Market

Over the past few decades, the U.S. automobile market has been transformed for the better, from what was the preserve of an underperforming domestic oligopoly into a thriving, globally competitive, consumer-driven marketplace. In 1965, imports accounted for about 5 percent of U.S. vehicle sales, but they achieved a nearly 25 percent share by 1980, as consumers sought alternatives to Detroit's limited offerings.[4]

In the face of growing import competition and more demanding consumers, the Big Three diversified and improved their product lines from the low point of the 1970s. As style, quality, and fuel efficiency improved, the Big Three's share of the U.S. market rebounded as well. On the cost side, the U.S.-Canadian Free Trade Agreement of 1988 and the North American Free Trade Agreement of 1993

Cato Institute • 1000 Massachusetts Ave., N.W., Washington, D.C. 20001 • (202) 842-0200
Fax: (202) 842-3490 • www.freetrade.org

enabled domestic automakers to fully integrate their North American operations with Canada and Mexico, leading to more efficient production and higher-quality vehicles.

Meanwhile, foreign producers began supplementing their exports to the United States by establishing U.S. production facilities. The first foreign-owned automotive plants in the United States were built in the 1980s as part of a strategy to avoid trade barriers on imported cars, but the rationale changed over the years as the advantages of employing skilled Americans to produce high-quality vehicles close to the world's largest market became apparent. With a tariff of only 2.5 percent on imported cars and minivans, and an abundance of cheap labor and lower-valued currencies in other countries, foreign automobile manufacturers continue to expand and invest in new production facilities in the United States. In the highly competitive automobile industry, a successful strategy involves something other than finding the cheapest production platform from which to export. The fact that imports now merely supplement U.S. production of foreign nameplates—rather than the other way around—attests to that fact.

In 2004, 16.9 million light vehicles were sold in the United States, of which 2.4 million, or 14 percent, were imported from Asia, while 3.5 million, or 21 percent, were Asian nameplates produced in the United States.[5] Of the nearly 1.7 million Toyotas sold in the U.S. market in 2004, nearly 3 of every 4 were produced in the United States, which was a greater share than in the previous year. Over 81 percent of the nearly 1 million Hondas sold in 2004 were produced in the United States, which was an increase from the 78 percent rate attained in 2003. Nissan's U.S.-produced vehicles accounted for 86 percent of its U.S. sales in 2004, which was a big shift from the 66 percent rate of the previous year.[6]

In fact, each of the top 10 selling cars and top 10 selling trucks (pickups, SUVs, and minivans) in the first half of 2006 is produced at facilities in the United States.[7] Toyota Camry, Honda Accord, Chevy Impala (GM), Ford Taurus, Nissan Altima, Ford Explorer, Chrysler Town & Country, and the other models that round off the most popular 20, regardless of the location of company headquarters, are produced in U.S. plants by American workers who contribute to the local, state, and national economies through their employment, expenditures, and taxes.

Today, as in years past, the Big Three still dominate domestic production, but the foreign-owned share continues to grow. In 2004, foreign-owned plants accounted for 28.7 percent of the 12 million vehicles produced in the United States that year. The leading foreign-owned producers were Toyota (1,247,708 vehicles), Honda (814,620), and Nissan (754,716). BMW, Fuji-Subaru, Mitsubishi, and Mazda each produced about 100,000 to 150,000 vehicles. In comparison, GM produced 3,597,917 vehicles domestically in 2004, Ford 3,056,530, and DaimlerChrysler 1,894,211.[8]

Likewise, while foreign nameplates have been capturing a larger share of the U.S. market, only Toyota's share ranks among the Big Three's. In the first half of 2006, GM sold the most light vehicles and accounted for nearly 25 percent of the market. Ford followed with an 18 percent share. Toyota ranked third with a 15 percent share, and Chrysler accounted for 14 percent.

The growth of a foreign-owned but domestically based automobile manufacturing sector has further blurred the lines between "us" and "them." Indeed, the very notion of a Big Three automobile industry has virtually ceased to have any real meaning. One of the Big Three, Chrysler, merged with the German automaker Daimler Benz in 1998. GM, which just sold its 20 percent stake in Fuji Heavy Industries (makers of Subaru), holds a 12 percent equity stake in Isuzu and a 3 percent stake in Suzuki. Ford owns one-third of Mazda's equity. And DaimlerChrysler, which just sold its 37.5 percent stake in Mitsubishi Motors, holds 85 percent of Mitsubishi Fuso Truck and Bus.

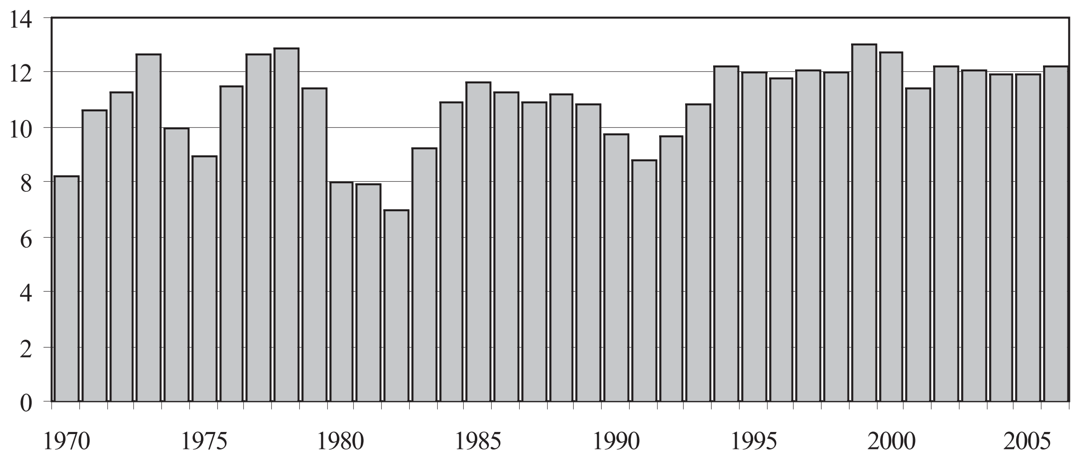
Meanwhile, each of the Big Three has deeply integrated its production supply chains with operations in Mexico and Canada under the successful North American Free Trade Agreement. Japanese-, German-, and Korean-owned automobile factories in the United States employ American workers, pay domestic taxes, invest heavily in new equipment, research, and development in their American plants, and buy huge quantities of parts from producers in the United States. Parts suppliers have tended to migrate along with the assembly plants. The Japan Automobile Manufacturers Association estimates its members spent $45.2 billion on vehicle parts from U.S. suppliers in fiscal year 2004.[9] And that figure should grow in light of new plans to construct or expand production facilities in the United States. Honda has announced plans to build a new plant with the capacity to produce 200,000 vehicles per year, which will employ 2,000 workers in Greensburg, Indiana. And, a Chinese-owned company purchased the rights from a British company to produce MGs in Oklahoma.

In the face of dramatic changes in ownership and market share, overall domestic U.S. automobile production has remained remarkably steady. From 1970 to 1993—from the heyday of the Big Three through the year before NAFTA went into effect—the average number of motor vehicles assembled in the United States each year was 10.4 million. From 1994 through 2005, the number of vehicles assembled per year rose to an annual average of 12.1 million[10] (see Figure 1). Not only are more vehicles being assembled than in the past, but the production is much more stable. During the earlier period, the standard deviation of output from year to year was 15.4 percent of average production, reflecting sharp swings in production in response to the business cycle. Since 1993, the standard deviation has dropped to only 3.3 percent of average production.

Domestic output of motor vehicles and parts has actually enjoyed a healthy increase since 1993 even if employment has not. In 2005, U.S. factories were manufacturing 68 percent more motor vehicles and parts in volume terms than in 1993. That compares with a 56 percent increase in U.S. manufacturing output overall during the same period.[11] The number of workers employed domestically in the production of motor vehicles and parts was 1,098,200 in 2005, down from a peak of 1,313,600 in 2000 but still above average employment levels in the early 1990s.[12] In light of increasing output, any decline in employment in the domestic automobile industry has been because of rising productivity and efficiency in the industry, not because of an overall decline in the industry's fortunes.

The biggest beneficiaries of a globally competitive U.S. automobile industry have been U.S. auto-buying consumers.

Figure 1
Motor Vehicle Assemblies in the United States (annual output, millions of units)



Source: Federal Reserve Board.

Increased competition has blessed automobile consumers with more choice, better quality, and protection from rising prices. Since 1993, during a period when the general price level has risen by 38.2 percent, the price level of new vehicles has risen a cumulative 4.1 percent—an annual increase of a mere 0.3 percent. In contrast, during that same period, the price level for health care services has risen by 70.4 percent and for education by 102.4 percent.[13] The same global competition that has made life more difficult for certain U.S. automobile makers has kept a lid on the prices millions of American families pay for a new car or light truck.

What's Really Ailing the Big Three

The troubles confronting the Big Three and Delphi clearly do not reflect a general malaise in the U.S. automobile market, but rather specific problems besetting those companies. As one Toyota executive accurately summarized, "The [U.S. automobile] market is healthy, though shifting."[14]

Amid these shifts, some representatives of the Detroit-based part of the U.S. automobile industry seek to attribute their woes to unfair foreign trade practices, most notably currency manipulation. But currency values have no direct impact on competition that is mostly domestic in nature. Japanese and Korean producers in the United States reap no competitive advantages vis-à-vis the Big Three if the yen or won is undervalued. And even if those currencies were intentionally undervalued, the fact is that both appreciated considerably against the dollar between 2002 (when the U.S. dollar peaked against most major currencies) and 2005. The yen appreciated by 12 percent and the won by 18 percent, yet the Big Three's share of the U.S. light vehicle market declined from 62.3 percent to 58.2 percent over this period.[15] Clearly, something other than currency values explains the shift.

One explanation for the Big Three's declining sales is that their collective emphasis on the pickup truck and SUV market has left them vulnerable to changing consumer demands, inspired largely by rising fuel prices. In 1990, cars accounted for 64 percent of GM's motor vehicle output and 58 percent of Chrsyler's. Of the Big Three, only Ford produced more trucks than cars in 1990. But by 2003, truck production accounted for 64 percent of GM's output, 74 percent of Ford's output, and almost 80 percent of Chrysler's output.[16]

Over the past couple of years, SUV sales have dwindled significantly. In the first six months of 2006, full-size SUVs are down 19.3 percent and mid-size SUVs are down 8.3 percent from the same period last year.[17] And U.S. pickup truck sales have declined 12.5 percent in the first half of 2006, relative to the same period in 2005.[18] Analysts have suggested that some of the Big Three's more fuel-efficient passenger cars have been experiencing sales increases lately but that it will take some time for consumers to overcome their association of the Big Three with larger cars, SUVs, and pickup trucks.

Another reason for the declining fortunes of the Big Three has to do with the union work rules with which production must comply. The Big Three have been committed to labor contracts that require them to support laid-off workers at 95 percent of salary, plus benefits, for the length of the contract. Facing these constraints, the Big Three opted against cutting back production and closing plants during the recession of 2001 and in the wake of the September 11 attacks, when demand for automobiles was tailing off. To sell their excess supply, the Big Three offered major discounts of up to $6,000 per vehicle or interest-free financing for up to 72 months.[19] Both the steep discounts and the cost of providing free loans in an escalating interest rate environment significantly eroded the companies' earnings.

The costs of high wages and extraordinary benefits, incurred pursuant to union contracts, are perhaps the most significant explanation for the weakened state of the Big Three. While all of the Big Three's U.S. facilities are organized by the UAW, none of the U.S. facilities fully owned by Japanese, Korean, or European companies employs union labor. According to a UAW document titled "The Union Advantage in Pay and Benefits," wages and benefits for the average union worker in the private sector totaled $31.94 per hour in 2004, compared to $22.28 per hour for the typical nonunion worker.[20]

The differential is even more pronounced for workers in the goods-producing industries (as opposed to services-producing). There, the typical union worker receives $35.78 in hourly compensation, while a nonunion worker receives $24.90.[21] All of this amounts to about a $1,000 per vehicle labor cost advantage for U.S. foreign-nameplate producers.[22]

Beyond the distortion in costs attributable to current wages and benefits, the financial performance of the Big Three is seriously hampered by mounting health care, pension, and other nonwage costs. GM CEO Richard Wagoner estimates that every GM vehicle built in North America includes $1,525 of health care costs, typically more than the value of the steel in the same vehicle.[23]

As relative newcomers to U.S. production, the foreign-nameplate producers are not burdened with the health care and pension requirements of so many retirees. The Automotive Trade Policy Council, a representative organization of the Big Three, estimates that the average health care cost per Big Three vehicle is $1,220, while the comparable cost for the foreign-nameplate producers is $450.[24]

The one legitimate trade-related complaint made by the Big Three is not about imports but about exports. U.S.-based automobile manufacturers do face tariff and nontariff barriers when exporting U.S.-made cars to several major foreign markets, including Japan and South Korea. But potential sales in those markets, even under ideal free-trade conditions, are simply not large enough to transform the fortunes of Ford and GM. Larger American-style vehicles are simply not attractive to consumers in such densely populated markets, and even less so as already high gasoline prices climb even higher in those markets. The U.S. government should continue to press our trading partners to lower their barriers to cars from the United States, but the misguided trade policies of other countries do not justify adoption of equally misguided policies by our own government.

Conclusion

There are plenty of valid explanations for the relative decline in market share of the Big Three automobile producers. "Unfair trade" is not among them. But complaints about foreign competition and calls for action are not an idle threat.

In the early 1980s, Congress bailed out a faltering Chrysler Corp. by guaranteeing a huge package of loans. To preserve the market share of the Big Three U.S. automakers, GM, Ford, and Chrysler, the Reagan administration bullied Japan's government into restraining the number of cars its producers exported to the United States. In the 1990s, the Clinton administration attempted unsuccessfully to force the Japanese into a form of managed trade. Intervention today would be as unnecessary and as potentially damaging as it was in the 1980s and 1990s.

Policymakers in Washington would be foolish to intervene in a market that is working so clearly in the interest of the large majority of Americans. What may be good for the short-run interests of certain U.S.-headquartered automakers would almost certainly not be good for America as a nation.

1. Sholnn Freeman, "GM Investors Show Frustration," *Washington Post*, June 7, 2006, p. D2.; and Erin Mays, "Yen rate gives Japanese automakers unfair advantage, Chrysler's LaSorda says," Autoblog, June 3, 2006, available at www.autoblog.com/2006/06/03/yen-rate-gives-japanese-automakers-unfair-advantage-chryslers/.
2. Office of Sen. Carl Levin, "Statement of Senator Carl Levin at the DPC Oversight Hearing on Trade Policy and the U.S. Automobile Industry," Press Release, February 17, 2006, available at www.senate.gov/~levin/newsroom/release.cfm?id=251708.
3. Jeffrey McCracken, "UAW Leader: Solutions to Problems Are Political" *Wall Street Journal*, June 13, 2006.
4. Ward's Automotive Yearbook, 2005, p. 239.
5. Ward's Automotive Reports, "Ward's U.S. Light-Vehicle Sales by Brand and Group-December 2005," January 9, 2006, p.1. Light vehicles include passenger cars, minivans, SUVs, and most pickup trucks. Light vehicles accounted for 98 percent of total U.S. vehicle sales in 2004.
6. Ward's Automotive Yearbook, 2005, p. 241–242.
7. Ward's AutoInforBank, "Ward's 10 Best Selling U.S. Cars and Trucks, 6 months 2006," www.wardsauto.com.
8. International Organization of Motor Vehicle Manufacturers, "Motor Vehicle Production in the United States by Manufacturer," available at www.oica.net. Vehicles include cars, light commercial vehicles, heavy trucks, busses, and coaches.
9. "Growing Investment and Employment in America," Japan Automobile Manufacturers Association, 2005, p. 8, www.jama.org. The figures apply to the Japanese fiscal year 2004, which covers April 2004 through March 2005.
10. U.S. Federal Reserve Board, "G. 17 Industrial Production and Capacity Utilization, Table 3, Motor Vehicle Assemblies," www.federalreserve.gov/releases/g17/table3.htm.
11. U.S. Federal Reserve Board, "Industrial Production: Market, Industry Groups, and Individual Series," series G3361T3 for "Motor vehicles and parts" and series B00004 for "Manufacturing," available at www.federalreserve.gov/releases/g17/ipdisk/ip_sa.txt.
12. Bureau of Labor Statistics, U.S. Department of Labor, "Employment, Motor Vehicles and Parts, NAICS Code 3361, 2, 3," www.bls.
13. Consumer Price Index—All Urban Consumers (Current Series), http://data.bls.gov/cgi-bin/dsrv?cu.
14. Sarah A. Webster and Joe Guy Collier, "Cars sales gain on trucks in May," *Detroit Free Press*, June 1, 2006.
15. Currency values come from Federal Reserve Statistical Release G.5A, "Annual Foreign Exchange Rates." Market share data compiled from figures in Ward's Automotive Yearbook 2005, p. 242 and Ward's Automotive Reports, January 9, 2006, p. 1.
16. Stephen Cooney and Brent D. Yacobucci, "U.S. Automobile Industry: Policy Overview and Recent History," CRS Report for Congress, April 25, 2005, p. 27.
17. Don Hammond, "Trend toward Smaller Cars is Leaving SUV's Behind," *Pittsburgh Post-Gazette*, July 11, 2006.
18. Poornima Gupta, "Slow Truck Sales Add Pressure on Detroit Automakers," Reuters, July 10, 2006.
19. Cooney and Yacobucci, p. 44.
20. United Auto Workers, "The Union Advantage in Pay and Benefits," http://uaw.org/organize/advantage.cfm.
21. Ibid.
22. Paul S. Kersey, "A Hard Pill for UAW Members to Swallow," Mackinac Center for Public Policy, September 2, 2003.
23. Ibid., p.44.
24. Ibid.