

Cato Institute Policy Analysis No. 83: Foreign Manufacturers in the United States: Should They Be Told to Buy American?

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Executive Summary

American protectionists have set their sights on a new target: foreign manufacturers, especially Japanese automakers, that have built plants in the United States. A small but politically vocal coalition of American auto parts manufacturers and their unions is complaining that Japanese automakers located in the United States do not buy enough American-made parts for their cars and that this is unfair and discriminatory. By purchasing auto parts from Japanese suppliers located in Japan and in the United States, Japanese automakers are accused of nothing less than a conspiracy to "colonize" American industry: "The Japanese conceived a grand design years ago to supplant the U.S. not only as the world's No. 1 carmaker but as the world's largest parts producer." [1] The protectionists seek government action that would compel Japanese automakers to purchase more of their products, and the issue is under investigation by the U.S. International Trade Commission.

This report investigates these complaints of unfair competition and discusses the economic impact of increased international competition in the auto parts industry. It shows that the complaints of discrimination against American companies are untrue. In fact, Japanese automakers do not discriminate against American parts suppliers per se--only against the ones that offer inferior or uncompetitive products. Japanese manufacturers do business with hundreds of American parts suppliers. These particular American suppliers are not complaining about unfair competition but are busy striving to make their products more competitive in the international marketplace.

The increased competition provided by Japanese auto parts manufacturers provides significant benefits to the auto industry and workers and to consumers. Consequently, any legislative action that restricted such competition would have harmful effects on the economy. As with all protectionist legislation, such actions would provide short-lived benefits to a small segment of the auto parts industry but would be harmful to the industry in the long run by reducing its incentives to produce better products.

The Domestic Auto Parts Industry

The American auto parts industry accounts for over \$100 billion in annual sales and comprises more than 3,000 companies, about two-thirds of which are small firms with fewer than 20 employees. There are also a number of large corporations such as Borg-Warner, Colt Industries, Federal-Mogul Corporation, and A. O. Smith. [2]

The business of the auto parts companies falls into two general categories: original equipment (parts and accessories for new cars) and replacement, or "aftermarket," parts. Original equipment producers are classified as those that

chiefly make wheels, bodies, frames, axles, transmissions, bearings, valves, bumpers, brakes, carburetors, upholstery fabrics, and cushioning materials. Aftermarket producers are those that make such products as spark plugs, piston rings, batteries, shock absorbers, thermostats, condensers, breaker point sets, and oil, air, and gas filters. Original equipment sales depend largely on the number, size, and complexity of new cars being built, as well as the competitiveness of the parts suppliers themselves. By contrast, replacement parts sales depend primarily on the volume of automobiles in operation.

An estimated 15,000 parts and accessories are used in an average automobile, many of which are produced by the thousands of small, independent auto parts suppliers. These basic statistics provide an indication of how specialized the parts industry is. Auto parts makers tend to specialize in a few items requiring a high degree of skill.

Because there are so many companies producing so many different parts and accessories, it is difficult to break the industry down into many distinct categories. However, two broad categories of importance to this study are (1) the parts divisions of domestic automakers and (2) the smaller, independent parts suppliers. The smaller, independent suppliers often have a cost advantage over the parts divisions of the so-called Big Three automakers because of

the ability to spread outlays for research, product development, and tools and dies over several contracts. Also, car makers often prefer to let independents do much of the engineering on new models; this speeds their introduction, divides the heavy development expense, and minimizes exposure to damaging strikes. [Independent] parts suppliers often have lower labor costs vis-a-vis the wages and fringe benefits characteristic of the auto manufacturers' unionized plants.[3]

This is an important distinction, for not all automotive parts suppliers are adversely affected by the advent of Japanese manufacturers locating in the United States. As shown below, the higher-cost auto parts suppliers have had difficulty winning contracts, but more efficient American companies have welcomed the new business opportunities provided by U.S.-based Japanese automakers.

Complaints Against Japanese Manufacturers

Japanese companies have constructed manufacturing facilities in many industries in the United States, including the automobile and electronics industries in recent years. However, it is the automobile parts industry that is currently perceived as being under siege.

Nearly 50 Japanese automotive parts suppliers have constructed facilities here since 1979, most of them clustered around new Japanese automobile assembly plants in California, Tennessee, Michigan, Ohio, and Illinois. Hundreds more suppliers are reportedly planning American plants in the next few years, and local governments throughout the United States are competing vigorously for them. Local government officials view the Japanese plants as a major source of investment, employment, and tax revenues for their communities.

However, despite the warm welcome given the Japanese parts manufacturers by local communities--and especially by the unemployed in those communities--they are resented by some of their American competitors. A subgroup of American auto parts manufacturers feels it is being discriminated against by U.S.-based Japanese automakers that prefer to purchase some of their parts from Japanese suppliers. In short, the industry subgroup feels it is being discriminated against because it is American, not because it cannot produce auto parts as well as Japanese companies can.

One specific complaint is that the Japanese automakers discriminate against American parts manufacturers by providing prospective American suppliers with only sketchy specifications of what they want. Said one American parts supplier: "The specs the Japanese car companies distribute to suppliers are incomplete. . . . It's like opening a box of Cracker Jacks and finding no prize in it." [4] Another supplier complained that he "received [from a Japanese automaker] a drawing for a component that showed only the exterior, leaving the internal parts to . . . engineers' imaginations." [5]

Such complaints reveal that these particular suppliers are discriminated against not because they are Americans but because they are unimaginative and uncompetitive. It is unfortunate to hear an American businessman complain that

his customers expect him to use his imagination.

The Japanese and U.S. automotive industries operate differently. Japanese manufacturers typically ask suppliers--regardless of location or national origin--to assume more responsibility for engineering design. In many cases, the Japanese automakers do not own patent rights to the designs for the parts they use, so that the parts suppliers must be quite specific. By contrast, American automakers usually provide detailed designs and ask suppliers to bid on a part. This is a fact of life in the auto parts industry, and complaining about it will get American suppliers nowhere. Those American suppliers--and there are many--who take it upon themselves to provide the designs and compete for the business will succeed; those who don't will fail.

Now that American suppliers are faced with greater competition from abroad, they will have to either meet the competition or go out of business. This challenge is healthy for the American auto parts industry, for its managers have more incentive to invest in product improvements and cost-cutting measures. By contrast, protectionist legislation that would temporarily guarantee American suppliers a larger portion of the market would reduce such incentives and thereby weaken the industry. There would be no reason for suppliers to be imaginative and invest money in product improvements if their market were guaranteed by law.

Japanese automakers have good economic reasons for rejecting the products offered by certain American parts suppliers. Honda, for example, stopped using PPG as its sole glass supplier because "the company delivered windshields with distortions, chips, and scratches." [6] Honda also let contracts with some American stamping manufacturers run out because "the welds of one company that has supplied us since 1983 were weak, welds and fasteners were missing on some components, and some parts were rusty." [7] A representative of Nissan stated that "we have had problems with the surface finish of parts we get from some American suppliers . . . and with glued parts that don't hold together when we get them." [8]

Such poor performance has meant that some American parts suppliers have lost business not only with Japanese manufacturers but also with American automakers. Faced with fierce international competition, the Big Three automakers have even turned away from some of their own divisions to purchase parts from the best possible sources, including Japanese suppliers. For instance, General Motors used to buy nearly all of its heating and air conditioning systems from its Harrison Radiator Division. Now it buys them from a number of outside suppliers, including a Michigan subsidiary of Nippondenso, Japan's largest manufacturer of auto parts. [9] Said one General Motors executive: "I can understand that our suppliers are upset. . . . But we've got to buy from world leaders. If the best happen to have off-shore roots, so be it." [10] To the extent that there is discrimination in the auto parts supply business, it is economic discrimination, which is healthy for the industry.

The above account is a good example of an American automaker meeting the challenge of international competition by taking the necessary steps to improve its competitiveness rather than pleading for protection (although General Motors is not without blame on that score). If the industry's parts suppliers are also to survive, they must take comparable steps. And there is increasing pressure for them to do so. American automakers are beginning to make Japanese-style product quality demands of their suppliers. This is precisely how international competition strengthens the automobile industry. Such product quality improvements would be delayed or nonexistent if automakers and parts suppliers were given legislative protection.

Do Japanese Automakers Use American-Made Parts?

At a recent hearing of the U.S. Senate Labor and Human Resources Committee, a representative of the United Automobile Workers union stated the UAW's main objection to Japanese auto parts suppliers locating in the United States:

U.S. parts producers, despite repeated efforts, have been unable to win significant contracts to supply . . . equipment or replacement parts to Japanese producers. . . . [W]e are told by suppliers that they are not given a fair chance to compete for business at these U.S. operations. . . . The results of this unfair treatment of U.S. suppliers will be terribly damaging to the U.S. industry if present trends continue. [11]

This statement would be correct if one more word was added: "Some." Some, but not all, parts producers have been

unable to win contracts with Japanese manufacturers. The more efficient suppliers have done very well, and they welcome the additional business opportunities provided by the Japanese firms. For example, as of September 1986, Nissan Motor Manufacturing Company's new plant in Tennessee was doing nearly \$400 million worth of business with 92 U.S. parts suppliers, including the purchase of 3,000-4,000 Champion spark plugs each month. Unlike the businesses complaining about unfair competition, these American companies have succeeded in a very competitive environment. According to Marvin T. Runyon, chief executive officer of Nissan U.S.A.,

National or corporate origin is of no consideration to us in choosing suppliers. . . . We cannot afford to base parts procurement decisions on non-economic criteria. . . . As a result, we buy parts from suppliers in Japan, the United States, Canada, and Mexico. . . . The process by which we select from among those suppliers is rigorous. Potential sourcing candidates for each part to be sourced are carefully reviewed by our Product Engineering, Supplier Quality Assurance and Purchasing Departments. On-site visits are conducted and specifications are reviewed with the potential candidates. Where appropriate, prototype samples are requested. Once a preliminary determination is made that certain suppliers--wherever located--can meet our quality and delivery standards, bids are requested. Sourcing decisions are then made on the basis of a financial analysis of each candidate's cost competitiveness.[12]

Runyon also stated that "for the most part, our domestic [that is, American] suppliers have exhibited outstanding performance in our quality program and they have controlled their costs well. . . . In fact, we're currently considering joint ventures with several U.S. parts manufacturers." [13]

Thus, the apparent discrimination is not against some American companies because they are American but because they are poor performers. The possible link between poor performance and unionization might explain why the UAW is so opposed to competition in the auto parts industry. Work rules, feather-bedding, and wages that exceed workers' marginal productivity all impose costs on American auto parts suppliers that make them less competitive.[14] Protectionism is a way through which unions can attempt to avoid bearing the costs of these impediments--namely, the unemployment that necessarily accompanies work rules and above-competitive wages and benefits. The UAW seeks legislation that would compel automakers to use parts produced by high-cost unionized firms instead of the most economical sources, wherever they may be found. This is a very short-sighted strategy, for in the long run it would be harmful to employment opportunities for UAW members. Such laws would make U.S.-based automakers less competitive, causing them to lose even more of the market to foreign competition and further reducing the demand for autoworkers in the United States.

There are many other examples, besides Nissan, of Japanese automakers doing business with American parts suppliers. Globe Industries, a producer of sound-control and acoustical equipment, has been selling sound-absorbing materials to Honda since 1980.[15] Toyota will equip 300,000 of its cars with Monroe shock absorbers. In addition, Toyota recently entered into an agreement to import other Monroe products to Japan; is using polishing agents made by a U.S. firm, McKesson; and is importing floor mats made by another American firm, Viam. Honda also does business with many American parts suppliers, which provided approximately 24 percent of all parts used in its American-built cars in 1986.

Further evidence that Japanese automakers are not discriminating against American parts suppliers is that some American suppliers are entering into joint ventures with Japanese companies. For example, a manufacturing subsidiary of ITT Corporation has joined with Sanoh, a small Japanese company that has contracts with several Japanese automakers. Delco Moraine, the brake systems division of General Motors, is negotiating a joint venture with Akebono, Japan's largest independent supplier of brake components. Overall, there were 27 joint ventures between Japanese and American companies in the auto industry in 1985.[16] Such ventures are beneficial to each firm (otherwise there would be no such ventures) and usually result in improved performance. Each participant can learn from the other, thereby strengthening each firm's performance and improving its profitability.

These facts all belie the claim that Japanese management somehow discriminates against American companies because they are American. Such claims are another example of "Japan bashing"--blaming Japanese competitors for domestic firms' shortcomings. As tough competitors, Japanese automakers discriminate only against poorly performing companies, as do American companies in the automobile industry and elsewhere.

As the number of Japanese automobiles produced in the United States increases, the business opportunities for American auto parts suppliers will also increase. Those companies that fail to make changes and that complain about imaginary prejudice are not likely to be successful at capitalizing on these opportunities.

Foreign Manufacturers' Use of Foreign-Made Parts

There are sound economic reasons why many Japanese manufacturers may be hesitant to switch to American suppliers. For example,

Japanese parts makers almost invariably belong to industrial groups of which the car company is a key member. The automaker typically owns stock in a supplier, and its executives often sit on the board. Relationships between the two tend to be exclusive, long-term, familial, and characterized by trust, loyalty, and a tacit awareness of what each can expect from the other. Even when the carmaker is not a part owner of the supplier, it exerts considerable control: In form the Japanese may look like independent suppliers, but in substance they are divisions of the auto companies. . . . Suppliers share all cost information with the automakers, and the companies work closely to boost productivity and reduce costs.[17]

Thus, many Japanese parts suppliers locating in the United States are effectively divisions of the Japanese manufacturing companies located here. The manufacturers are vertically integrated-- they own their own parts supply divisions--and they are moving some of these divisions here with their own operations.

There are many economic reasons for vertical integration and for the desire of some Japanese automakers to maintain that type of corporate structure. One advantage is that such arrangements limit so-called opportunistic behavior problems created by the divergence in the incentive structures among different levels of production--that is, manufacturers and suppliers.[18] General Motors' purchase of Fisher Body, for example, occurred partly because of an inability of both firms to reduce undesirable behavior through contract clauses. Before the merger, Fisher Body continually attempted to renegotiate its contracts through the tactic of production delays. It had the bargaining leverage to do this because production delays were very costly to General Motors. Alternatively, General Motors, which held the design patent, attempted to renegotiate through reduced purchases of auto bodies that were produced by Fisher but that were salable only to General Motors. Vertical integration was a way of eliminating such wasteful gaming activity to the benefit of both parties.

Another advantage of vertical integration is that it helps businesses avoid costs incurred by searching for supply prices, closing contracts with suppliers, revising contracts, collecting payments, communicating work specifications, and so on. Also, vertical integration can be a way of redistributing risk bearing in a way that improves the efficiency of a business organization. For example, a parts supplier may find it too risky to carry a large inventory in light of constantly changing demand conditions, such as exist in the auto industry. But it may be able to merge with a large manufacturer that is willing to bear the risk and carry the parts inventory. Research has shown this type of merger to be an economical type of organization.[19]

Other advantages of vertical integration include the elimination of transportation costs when an input supplier can locate next to a manufacturer and the avoidance of price controls. In the latter case, if price controls are placed on, say, an input into the production process, the inevitable problem of shortages of the input can be overcome by manufacturers that purchase their own input suppliers and can then use the supplies at the most appropriate rate.

In sum, vertical integration is sometimes, but not always, a source of efficiency, which is undoubtedly why many U.S.-based Japanese manufacturers--like American automakers--own and operate some of their own parts-supplying subsidiaries. To the extent that such arrangements enhance industrial efficiency, protectionist legislation that would limit them would harm these U.S.-based Japanese companies. They would become less competitive, which would cause them to cut back production and lay off some of their American employees. This trend would eventually mean a loss of jobs in the auto parts supply industry as well, for the demand for workers in that industry is a "derived demand"-- that is, it is derived from the consumer demand for the final product, cars.

This is not to imply that American auto parts suppliers that do not currently do business with U.S.-based Japanese companies are at a permanent disadvantage. For one thing, vertical integration is not always a lower-cost alternative to

contracting out with independent suppliers, once all the relevant costs are considered. Even though there are many costs of dealing with independent suppliers rather than in-house subsidiaries, these costs can possibly be compensated for by lower prices charged by independent suppliers of auto parts. The advantages of vertical integration may be countered by the advantages of specialization in the parts supply industry.

In a dynamic world, businesses must adapt to make use of the least-cost methods of production. In different situations, vertical integration and disintegration are alternative ways of achieving such economies. What is important is that businesses adapt to changing circumstances. Protectionist legislation that would interfere with such corporate restructuring would therefore reduce the competitiveness of the American automobile industry.

As mentioned above, several American automakers have decided to vertically disintegrate--to do business with independent parts suppliers rather than their own subsidiaries--once the independent suppliers became more efficient. Chrysler currently gets about 70 percent of its auto parts from independent suppliers, while Ford gets about 60 percent and General Motors gets 25 percent. Ten years ago, the proportions were 50 percent at Chrysler, 45 percent at Ford, and 20 percent at General Motors.[20] U.S.-based Japanese automakers can be expected to do the same--and some already have--when the opportunity presents itself. In fact, foreign investment by Japanese companies and others in the automobile industry can provide many improved business opportunities for American auto parts suppliers, for the domestic industry already is quite specialized and many American parts suppliers have won lucrative contracts from the new Japanese firms. These contracts never would have materialized if the foreign investment had not taken place, and they will disappear if protectionist legislation makes such investment unprofitable. It has long been recognized that the highly specialized American auto parts supply industry provides automakers with efficiency-enhancing opportunities. For example, economist Edward A. Robinson described the process of vertical disintegration in the following way in 1958:

Where some given process requires a scale of production considerably greater than the smaller firms in an industry can achieve, this process tends to be separated off from the main industry, and all the smaller firms get this particular process performed for them by an outside specialist firm. Thus the industry becomes broken up into two or more industries, and each is enabled to work at its most convenient scale of production. The specialist firm, working for a number of the smaller firms, is on a larger scale than any of the individual firms could have achieved for that particular process or product. Examples of this principle may be found in . . . the manufacture of various component parts, such as radiators, electrical equipment, body shells, and crank-shafts and other forgings, in the motor industry.[21]

With the arrival of new Japanese automakers in the United States, many American auto parts suppliers have already served this function. As mentioned above, Japanese manufacturers do business with hundreds of American parts suppliers. It is only the less efficient suppliers who are complaining of discrimination, but then, they can be expected to complain regardless of the countries of origin of their successful competitors--Japan, Canada, Mexico, the United States, or anywhere else. Because there is already a specialized auto parts supply industry in the United States, the entry of Japanese auto parts suppliers is a healthy development for the industry. The competition will provide the incentive for American parts suppliers to produce better products for the growing market created by the new U.S.-based Japanese auto assembly plants. Without these competitive pressures, the American auto parts supply industry could conceivably let this opportunity slip away.

The U.S. Department of Commerce recently detected that many American auto parts suppliers have responded to the competition not by running to Congress and asking for protection but by improving their products. Specifically, some companies have introduced a "just-in-time" production and inventory control system similar to that used by Japanese manufacturers and their suppliers. According to the Department of Commerce,

The automobile makers' interest in the "just-in-time" production and inventory control system . . . will have a substantial impact on . . . supplier costs. Under this concept, vehicle manufacturers minimize parts inventories by requiring suppliers to deliver on a precise schedule. To gain all the economies that "just-in-time" can provide, suppliers must fit their production and delivery schedules to the vehicle-makers' assembly schedules. Improvements in product quality and adjustments in production methods, delivery systems, and plant locations may become necessary to assure delivery reliability. Application of the "just-in-time" concept to the degree employed by Japanese car manufacturers is not expected, but U.S. vehicle producers will apply the concept to the greatest extent possible.[22]

One example of this phenomenon is Delco Electronics in Kokomo, Indiana, where, because of recessions and international competition, the unemployment rate was as high as 23.5 percent in 1980.[23] The unemployment rate is now less than half that, and one reason is Delco's competitive strategy. Delco, a producer of automotive electronic systems, "is switching to the just-in-time method of inventory control so popular in Japan. By receiving supplies in smaller and more frequent batches . . . the company . . . will avoid potentially costly inventory build-ups." [24] This strategy has helped Delco to become more competitive and thereby be in a position to rehire some of its former employees. Some of Delco's own suppliers have also located closer to Delco's assembly plant in response to its need for quick delivery.

General Motors has also adopted the just-in-time inventory method, which prompted several of its suppliers to relocate next to its Baltimore plant.[25] And before Nissan even opened its plant in Smyrna, Tennessee, in fall 1983, some of its American suppliers located near its plant site, thereby providing hundreds of additional jobs for that community.

These are American manufacturing success stories that have been overlooked by all the gloomy reports of the manufacturing sector's alleged relative decline. And a strong case can be made that increased competition by Japanese automakers in the United States is largely responsible for these successes.

Exclusive Dealing Contracts

Even if Japanese auto parts suppliers located in the United States are not subsidiaries of U.S.-based Japanese manufacturers, there are good economic reasons for the manufacturers to make use of exclusive dealing contracts with many of them. As mentioned above, some of the new Japanese manufacturing concerns in the United States have entered into exclusive dealing contracts with American parts suppliers for similar economic reasons. Among the major advantages of exclusive dealing contracts is that they help ensure the timeliness of supply and give the manufacturer greater latitude in making quality control decisions jointly with the supplier. Such contracts improve product quality, which can only be good for the industry. Moreover, they can hardly be "unfair," for there is nothing to stop any American auto parts manufacturers from competing for them. They only need to demonstrate that it is in the manufacturers' interest to do so by providing products that are competitive in quality and price. In fact, this is occurring in the domestic automobile industry. In return for cost savings, General Motors has put more than 30 percent of its parts business into multiyear, exclusive dealing contracts.[26] By doing this, the automaker hopes the suppliers, as sole vendors, will be able to cut prices because of economies of scale.

Rather than actually improving their products, many American auto parts suppliers have chosen instead to sermonize about their allegedly superior quality. However, this is a failing strategy, according to Nissan's Runyon:

My experience with a few U.S. suppliers makes me somewhat skeptical when I hear trade association representatives boast about the competitiveness of U.S. industry. We are not interested in generalizations. We are interested in company by company, product by product evaluation. Competitiveness can only be proved in the testing lab, on the production line, in the finance department, in the auto dealers' showroom, and ultimately in the hands of the consumer. It cannot be proved in press releases or hearing rooms.[27]

American parts suppliers that have focused their efforts on their assembly lines, finance departments, and testing laboratories have won contracts. As reported in Standard and Poor's 1986 Industry Surveys, many domestic auto parts producers "have invested heavily in engineering and specialized equipment and, thus, have become more efficient and cost competitive." [28] By contrast, domestic producers that have taken the alternative route of issuing gratuitous press releases, lobbying for protection, and complaining about prejudice have not fared well.

Economic Effects of Japanese Investment in the United States

Protectionists in the U.S. auto parts supply industry interpret the effects of direct foreign investment by Japanese automakers as calamitous for the industry. For example, Steve Beckman of the UAW stated, "These structural changes in auto industry production and sales could result in the loss of up to 500,000 jobs. . . . A large portion of this job loss will be in the auto parts and supplier industry." [29] Lee Kadrich of the Automotive Parts and Accessories Association issued a similar warning: if tariffs on imported auto parts do not remain intact, the result could be "a chain reaction of

declining competitiveness at home, lower output, job losses and more off-shore sourcing. . . . Free trade . . . remains the immediate threat . . . which must be stopped." [30] And Owen Bieber, president of the UAW, claimed that what is needed is "a trade policy which can effectively protect workers from worldwide transfers of capital and advanced technology. The constant search for low-cost production can only impoverish the American economy." [31]

Bieber's Orwellian statement that low-cost production is impoverishing turns reality on its head. A logical extension of this statement is that if resources were not scarce and production were totally costless, we would all be worse off. If low-cost production is impoverishing, according to this argument, zero-cost production would be much worse. It would also imply that the way for underdeveloped countries to become wealthier is to become high-cost producers of goods that are traded on international markets.

Ever since Adam Smith wrote *The Wealth of Nations* more than 200 years ago, it has been recognized that capital investment and technological advance have been a major source of increased wealth and employment worldwide. The above warnings are just another example of the worn-out and false view that capital investment and technological advance are impoverishing. Adam Smith exposed this myth in his famous story about a pin factory: a single worker without machinery, noted Smith, "could scarce, perhaps, with his utmost industry, make one pin a day," but with the introduction of machinery he could make nearly 5,000 pins a day.

The Luddite view that this development should have created massive unemployment in the industry was shown to be false. In fact, the greatly reduced price of pins expanded their existing use, and new uses were invented. Moreover, the increased real incomes of the users of pins enabled them to purchase more of other things, stimulating production and employment in those areas, including the production of pin-making machines. This is how technological change enhances economic growth and employment in the economy.

This basic economic truth was also ignored over a century ago when the economy was shifting from a predominantly agrarian to an industrial base. At that time, nearly 50 percent of the labor force was employed in agriculture-related industry, whereas less than 4 percent is today. This sharp decline has not created massive unemployment or impoverishment. To the contrary, job opportunities have expanded and technological advances in agriculture have enabled the United States to produce more food with fewer workers. Other workers have been able to pursue more lucrative occupations in the new industries. This is a classic example of how the search for low-cost production is wealth creating and welfare enhancing, not impoverishing. Most economists understand that technological change and the free flow of capital are important ingredients of economic growth. [32]

As a cost-reducing innovation, the introduction of lower-cost Japanese auto parts suppliers is bound to stimulate economic growth and employment in the United States. First of all, it is important to recognize that so-called Japanese auto parts suppliers located in the United States are American companies. They are located in this country, they hire American employees, they make their products here, and their exports are counted as American exports. They contribute to job creation and economic growth in the communities in which they are located and, indirectly, throughout the country. Communities around the nation are actively competing for such businesses. "Mayors and governors are bumping into each other in Europe and Asia at trade shows staged to woo foreign investment," wrote *Fortune* magazine. [33] As one successful example of these efforts, Governor Martha Layne Collins of Kentucky recently announced plans for a joint venture between Akebono Brake Industry of Japan and the Delco Moraine division of General Motors. [34] According to Collins, the plant will eventually employ 400 workers in the small town of Elizabethtown, Kentucky, and \$100 million will be invested in the facility in the next few years.

The presence of lower-cost Japanese auto parts suppliers does more than make the auto parts supply industry more competitive; it makes the American automobile industry in general more competitive. Lower-cost parts will help hold down the cost of American-made automobiles, which will also make them more competitive in international markets. The lower prices will cause the amount of demand to be higher than it otherwise would, which will stimulate employment in the automobile manufacturing industry. And when there is an increase in automobile production, there will inevitably be an increase in the derived demand for auto parts and for workers to produce them. Lower-cost production of American-made automobiles will also benefit the auto parts aftermarket by placing more cars in circulation. Thus, production and employment in that segment of the industry will increase as well

Lower-cost automobiles also mean that American consumers will have more money left in their pockets after their automobile purchases. They will be able to put that money to other uses, including the purchase of other goods and services. Consequently, there will be increased demand for other goods and services throughout the economy, thereby stimulating production and employment. To the extent that some of the money is saved, it will fuel capital investment, the lifeblood of economic growth. Just as in the example of the pin factory, the introduction of lower-cost production methods in the automobile industry will enhance prospects for more jobs and economic growth.

Finally, although the presence of Japanese automakers in the United States is a recent phenomenon and economic data regarding the effects of this new foreign investment are relatively scarce, the data that are available indicate there has been an increase in employment in the auto parts supply industry since the first Japanese automaker announced its plans to operate here in 1980. According to the Department of Commerce's 1985 and 1986 editions of Industrial Outlook, total employment in the automobile parts and accessories industry increased every year since 1981, from approximately 315,000 workers in 1981 to 381,000 in 1986. This includes increased employment for both production and nonproduction workers. Furthermore, average hourly earnings also increased in the industry, from about \$11 per hour in 1981 to \$13.57 in 1985 (the latest year for which data are available). Contrary to the calamitous claims made by the UAW and others, the data do not support at all the notion that Japanese direct foreign investment in the U.S. auto industry has caused unemployment in related industries, such as the auto parts supply industry. Rather, the data support the view that as economic reasoning suggests, such investment has been a boon for employment.

Static Economics Leads to a Static Economy

Advocates of protectionism don't recognize that their static view of the world fails to take into account how technology and competition alter relative prices and incomes and generate economic growth and change. For example, in evaluating the employment impact of Japanese competition in the auto parts industry, the UAW bases its estimate of 500,000 jobs "lost" on its conjecture that currently the average unionized American auto assembly plant is responsible for approximately 25,000 jobs, including employment in related industries such as raw materials and machine tools. By contrast, according to the UAW, the average Japanese auto plant creates only 6,700 jobs. So as Japanese plants replace their less efficient competitors, according to the UAW, approximately 18,300 jobs are "lost."

These estimates are similar to the claims made by the UAW and others that in the 1970s 38 million jobs were lost in manufacturing industries.[35] However, since there were not nearly 38 million unemployed people in the 1970s, it is clear that this statistic reveals simply that about 38 million people changed jobs as the economy continued to evolve and grow. Some industries grew, others did not; some businesses were successful, others failed. Jobs were not destroyed, for at the time there were more people working than ever before.

The construction of Japanese auto plants in the United States means there are more cars being produced here than there would be otherwise. Consequently, there are more job opportunities than would otherwise have existed. What is happening in the U.S. auto industry is that because of international competition, automakers are forced to cut costs and can no longer afford the restrictive work rules and the uncompetitive wages and salaries paid to their unionized workforce. Many of the Japanese automakers have chosen to build their plants in the mid-South because it "isn't a union stronghold like the Midwest. Thus, workers in the . . . plants there don't demand the same restrictive work rules that are found in most Big-Three plants. Less restrictive work rules are a major source of Japanese automakers' cost advantage, which U.S. producers such as GM hope to match with projects like Saturn." [36]

This is not to say that unionized plants cannot be competitive. After all, the Japanese automakers located in Japan are unionized and have done very well. And unionization did not stop Toyota from entering into a joint venture with General Motors in Fremont, California. In fact, General Motors says that the Fremont plant is its most efficient. What is important is to keep wages and fringe benefits more commensurate with worker productivity and to avoid restrictive work rules. The problem is that it is difficult to convince someone to join a union if the union can promise only competitive wages. Why pay the monthly dues and other obligations if the union can promise only that you will earn as much as you could without it? This is probably why many union leaders are opposed to the new competition: it forces them to change the way they do business, something they wish to avoid.

How International Competition May Benefit Unions

There is a potential benefit, even to unions, of the intensified competition in the auto parts supply industry. In addition to providing competition to American automakers and auto parts suppliers, the increased Japanese presence in the domestic auto industry can possibly even make unions more competitive. Because of the way Japanese management deals with its unions, unions have been less harmful to their business enterprises than American unions have to theirs. The General Motors-Toyota joint venture is a good example. Because it employs more Japanese-style labor relations, the Fremont plant is the most efficient General Motors plant. One consequence is that workers who highly value job security will be more satisfied with the Japanese style of labor relations that exists at the Fremont plant than with the style in other places. Thus, to compete for representation, unions may have to imitate some of the labor relations practices found in Japanese industries. To the extent that unionized Japanese businesses are more prosperous than many of their American counterparts, this change could be healthy for American unions and their members.