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DOMESTIC CONTENT LAWS: WILL THEY SAVE THE AUTO INDUSTRY?

INTRODUCTION

"Made in America." It is a proud, well-respected label. But should laws require that goods be made in the U.S.? This is the purpose of the so-called domestic or local content requirements. They are designed to force manufacturers selling in other countries to conduct at least part of their production there as well. These laws are most common in developing nations seeking to generate employment opportunities for their populace while building the base for a future domestic industry. They seem embarrassingly out of place in a developed, highly technological nation. Yet, this is precisely what may happen in the U.S.

A domestic content bill for automobile manufacturers is now before Congress. It has over 200 co-sponsors in the House and seventeen in the Senate. Primary supporters of the legislation are the United Auto Workers and automobile parts suppliers. Proponents tout the legislation as just the medicine to cure the American automobile industry's ills and put thousands of unemployed autoworkers back to work. Opponents fear the legislation could do more harm than good.

General support for domestic content laws rests on two basic tenets. Proponents argue that the manufacture of some products, in this case automobiles, is so important to the economy that whatever is necessary must be done to ensure the health of that industry. Backers of domestic content laws further maintain that producers with substantial sales in a foreign country have a responsibility to generate employment and economic activity there.[1]

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[1] Dick K. Nanto, "Local Content Laws and Automobile Imports: Arguments Pro and Con," Congressional Research Service Report No. 81-191 E, August 20, 1981, p. 1.

These arguments are not universally accepted. They are opposed, for example, by free market advocates who assert that the maximum benefits to a society are achieved through open trade where countries specialize and exchange goods freely. Even those who believe the U.S. should not completely open its borders, as long as other countries do not engage in free trade, seriously question domestic content in general and this law in particular.

The debate falls into five broad areas:

I. Those supporting the bill believe that the legislation would prompt considerable investment by foreign manufacturers in the U.S. Opponents disagree, claiming that instead producers of imports will reduce their sales to levels at which domestic content requirements do not apply.

II. The impact of the requirements on U.S. automakers is in dispute. Proponents claim the bill would put American manufacturers on a stronger footing in meeting competition from overseas. Those fighting the bills believe domestic content requirements actually will harm American automobile producers, severely damaging their ability to compete in a worldwide market.

III. There is disagreement over how consumers will fare under domestic content laws. Proponents predict neither dramatic price increases nor significantly reduced selection. Those opposing the bill feel that, because foreign manufacturers are unlikely to start operations in the U.S., the costs to American consumers will be substantial.

IV. Supporters maintain the chances of retaliation by other countries are slim. Opponents fear a major trade war may result.

V. The impact on U.S. jobs is being debated. Employment will unquestionably be created in the domestic automobile industry, but there is disagreement about how much. Meanwhile, opponents argue jobs will be lost in other export related American industries and that losses may actually exceed total employment gains.

Clearly, the potential impact of domestic content requirements deserves a closer look.

BACKGROUND

That the U.S. automobile industry is in a depressed state is not disputed. Sales of new U.S. automobiles and light trucks have fallen dramatically, resulting in extensive unemployment among autoworkers. Douglas Fraser, President of the United Auto Workers, estimates that 250,000 workers are now on indefinite layoff.[2] Faced with this large number of unemployed members and

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2 Statement of Douglas A. Fraser, President, United Auto Workers, before the Subcommittee on Commerce, Transportation, and Tourism of the House Energy and Commerce Committee, March 2, 1982, p. 2.

the apparently desperate state of the industry generally, the UAW is heavily supporting the domestic content bills--H.R. 5133 and S. 2300.

Proponents of the bills point to other countries which protect their auto manufacturers. In testimony before Congress this March, Fraser and Howard Samuel, President of the Industrial Union Department, AFL-CIO, told of the extent of market interference by various other governments.

In the last 20 years, they explained, the governments of Japan, Germany, France, Italy, and the United Kingdom all intervened at critical stages to save their national automobile producers from seeming destruction.[3] Italy, for example, has limited imports of Japanese autos to 2,000 units annually. France restricts Japanese imports to 3 percent of its domestic market, while Great Britain allows no more than 10 percent of total automobile sales to go to the Japanese.[4] Furthermore, over thirty countries now impose domestic content requirements on their automobile industries--among them Argentina, Brazil, Mexico, and South Korea.[5]

Supporters of the legislation also point out that no other manufacturing industry in the U.S. can match the auto manufacturers in terms of size or impact on the rest of the economy. Samuel claims that one of every five American jobs is linked to the auto industry.[6] The continuing depressed state of the industry is having ripple effects and harming other U.S. industries--particularly automobile parts suppliers.

It is further argued that action taken now can influence foreign automakers' decisions about where to buy parts and components as well as where to build new plants. UAW spokesmen note that this has occurred in other countries. Even though the automobile markets of Europe, Latin America, and other Asian nations are much smaller than that of the U.S., Japanese firms are making investment commitments in these parts of the world far in excess of those that have been made in this country.[7]

Proponents make two final arguments. They claim automakers have something of a moral obligation to generate employment in those countries in which they have substantial sales. Further, the free market approach pursued until now has not solved the

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3 <u>Ibid.</u>, p. 9.

4 Statement of Howard D. Samuel, President, Industrial Union Department, AFL-CIO and Chairman, Coalition of Automotive Component and Supply Workers, before the Subcommittee on Commerce, Transportation, and Tourism of the House Energy and Commerce Committee, March 2, 1982, p. 3.

5 Fraser, <u>op. cit.</u>, p. 8.

6 Samuel, <u>op. cit.</u>, p. 1,

7 Fraser, <u>op. cit.</u>, p. 9.

unemployment problems of the American automobile industry. As a result, conclude these spokesmen, domestic content laws are needed.

H.R. 5133 AND S. 2300

Introduced by Representatives Richard Ottinger (D-NY) and John Dingell (D-MI) in the House, H.R. 5133 is entitled the "Fair Practices in Automotive Products Act." As of early August, the bill had 218 co-sponsors. The companion piece of legislation in the Senate, S. 2300, was introduced by Wendell Ford (D-KY) and had seventeen co-sponsors.

The bills have two major sections: Title I--Domestic Content Requirements for Motor Vehicles and Title II--Unfair and Deceptive Practices of Vehicle Manufacturers. Title II would require an automobile producer to determine when domestically produced replacement parts satisfy reasonable standards for use in his automobiles and to supply notice to his dealers that such parts may be used. While potential problems with this section exist, debate has centered on the first section of the bill dealing with local content.

If they became law, H.R. 5133 and S. 2300 would require that by 1983 the overall fleet average of automobiles and light trucks (i.e., those weighing less than 10,000 pounds) sold in America have a fixed percentage of U.S. labor and U.S. and Canadian parts (or North American content). Following a phase-in period, by model year 1985, producers selling between 100,000 and 150,000 vehicles in the U.S. would need a fleet average of 25 percent North American content. Sales of between 150,000 and 200,000 annually would require 50 percent domestic content. Manufacturers selling from 200,000 to 500,000 vehicles would be required to maintain 75 percent local content, while sales over 500,000 units would carry a 90 percent North American content requirement. A firm failing to meet the requirements would be forced to reduce U.S. sales by 25 percent during the following model year.

The standards set by this legislation are much more stringent than those employed by the Environmental Protection and Conservation Act (EPCA) for determining whether fuel efficiency standards are met. EPCA standards count not only labor and parts toward domestic content (as H.R. 5133 and S. 2300 do), but some overhead items as well. For example, expenses incurred in marketing automobiles in the U.S. may be counted as part of local content as well as the servicing arm of the producer.

The stated goal of those supporting the legislation is to encourage investment by foreign manufacturers in the U.S.--particularly the Japanese. Thus, it is argued, jobs will be created for American workers and investment dollars now flowing overseas to U.S. automobile manufacturers' subsidiaries will be spent domestically.

IMPACT ON FOREIGN MANUFACTURERS

Table I lists the number of foreign cars and light trucks sold in the U.S. in 1981. Based on this, seven foreign auto producers would be directly affected by the legislation. To maintain their 1981 level of sales, Toyota and Datsun would be required to meet a 90 percent local content requirement. Honda, Volkswagen, and Mazda would have to raise their fleet averages to 75 percent domestic content. Subaru would have to meet a 50 percent requirement, and 25 percent of the Mitsubishi fleet (marketed in this country by Chrysler) would have to be produced domestically. Of the seven producers, six are Japanese. Only Volkswagen is European based.

Table I

Manufacturer	Cars and Light Trucks
Toyota	713,981
Nissan (Datsun)	580,139
Honda	370,705
Volkswagen (including those produced in the U.S. and imports of VWs, Audis, and Porsches)	340,555
Toyo Kogyo/Mazda	246,831
Subaru	152,062
Mitsubishi	110,940
Volvo	64,447
Mercedes Benz	67,113
BMW	41,761
Fiat (includes Lancia)	33,253
Jaguar/Rover/Triumph	18,956
Peugeot	16,937
Saab	14,613

Source: Dick K. Nanto, "Automobile Domestic Content Requirements," Congressional Research Service Issue Brief No. IB 82056, May 18, 1982, p. 9.

The UAW and others supporting domestic content legislation believe the foreign manufacturers will attempt to maintain their current level of sales in the U.S. and, thus, start building cars in this country, creating extensive employment opportunities for American workers. Others are not so sure. Potential roadblocks to foreign investment in this country are mentioned by several analysts.

A Congressional Research Service (CRS) report noted that the Japanese feel investment in the U.S. would raise costs and represent considerable risk. Japanese producers are leary of U.S. labor relations. The relationship between the Japanese auto manufacturers and their workers is much less adversarial than that of U.S. producers and the UAW. Furthermore, the Japanese feel their production costs would rise because of increased uncertainty about parts procurement--both from American and Japanese suppliers. This uncertainty would necessitate larger inventories of components and, hence, lead to higher carrying costs.[8]

Plant size may also cause problems. U.S. assembly plants must generally produce 150,000 to 200,000 units to attain sufficient scale to operate at lowest cost.[9] In addition, these plants usually produce one, at most two, models efficiently.[10] Thus, the larger Japanese manufacturers would be able to produce only a couple of models efficiently. But, even manufacturing their two top-selling models with 90 percent North American content would leave Toyota and Nissan well below a 75 percent local content level for their fleet.[11] Therefore, if foreign manufacturers were willing to make the kind of U.S. investment necessary to achieve efficient production as well as meet local content requirements, overcapacity in the U.S. automobile industry would result.[12]

Finally, there is a question of timing. In a letter to Representative John Dingell, the Federal Trade Commission suggested the phase-in period set by the bill may not be sufficient to allow serious consideration of extensive U.S. investment by the firms affected.[13]

Many of the more specific problems with the legislation become apparent by looking at how Honda and Volkswagen of America would be affected if these bills became law.

Volkswagen of America has been praised by Douglas Fraser as an example of a firm with a proper commitment to investment in the U.S.[14] North American content of VW Rabbits produced in the U.S. is approaching 70 to 75 percent as measured by EPCA. Under the definition of the bill now before Congress, however, the content of U.S. produced Rabbits is in the range of 40 to 45 percent. Furthermore, because the domestic content bills place content requirements on the fleet rather than the model, Volkswagen is far from meeting a 75 percent local content requirement. Volkswagen produced 197,000 cars in this country in 1980, but to provide its dealers with a complete line of automobiles, 91,000

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8 Nanto, <u>op. cit.</u>, p. 17.

9 Dick K. Nanto, "Automobile Domestic Content Requirements," Congressional Research Service <u>Issue Brief</u>, No. IB82056, May 18, 1982, p. 6.

10 Nanto, CRS <u>Report</u>, p. 19.

11 <u>Ibid.</u>, p. 4.

12 Charles P. Heeter, Jr., <u>The Arguments Against U.S. Domestic Content Rules for Automobiles</u>, The Government Research Corporaton, August 10, 1981, p. 8.

13 Letter from Carol M. Thomas, Secretary, Federal Trade Commission, to Representative John Dingell, p. 2.

14 Fraser, <u>op. cit.</u>, pp. 8-9.

additional VWs were imported along with 50,000 Porsches and Audis.[15] To meet the requirements of H.R. 5133 and S. 2300, VW would have to cease importing all other Volkswagen models, Audis, and Porsches. This actually penalizes Volkswagen relative to manufacturers with no presence in the U.S. These other firms would still be able to import up to 100,000 vehicles annually.[16]

Honda is in an even less enviable position. Honda has plans to begin production in Ohio this fall. Full output of 150,000 units annually is expected to be reached by mid-1984; the plant is expected to provide 2,000 jobs.

To start producing in the U.S. as soon as possible, Honda plans to import many components. This will result in a relatively high Japanese content for the Hondas made in America. Thus, Honda would be unable to meet the requirements of the legislation even with its U.S. production--at least at first. Honda maintains, moreover, that it will actively seek local suppliers, but necessary lead time and product specifications make it difficult to bring U.S. suppliers on line more rapidly.[17]

Based on these considerations, many analysts of the potential effects of H.R. 5133 and S. 2300 have concluded it is unlikely foreign manufacturers will rush to build production facilities in the U.S. In fact, most sources agree that local content requirements would actually discourage investment within the U.S. by reducing the flexibility of foreign manufacturers to use worldwide sourcing for components.[18]

IMPACT ON U.S. MANUFACTURERS

Arguing that increased imports are a primary cause of the high unemployment and low profitability of U.S. automakers, proponents of local content bills predict nothing but good for U.S. manufacturers. Supporters claim such laws would introduce a fairness now lacking in our auto-trade relationships with other countries by placing U.S. producers on a more equal footing with their foreign counterparts.[19] According to a Business Week editorial, a domestic content law would provide needed protection against Japanese imports while American manufacturers retool to

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15 "Domestic Content Legislation," Toyota Corporation, May 7, 1982, p. 3.

16 Nanto, CRS Issue Brief, p. 6.

17 Statement of American Honda Motor Company, Inc. on H.R. 5133, "Fair Practices in Automotive Products Act," before the Subcommittee on Commerce, Transportation, and Tourism of the House Energy and Commerce Committee.

18 See, for example, Heeter, pp. 8-9; Domestic Content Laws: Rx for a Permanently Non-Competitive Industry, American International Automobile Dealers Association, p. 9; or Letter from Darrell M. Trent, Acting Secretary of Transporation to Representative James T. Broyhill, p. 1.

19 Fraser, op. cit., p. 6.

produce small cars.[20] Without this legislation, it is argued, the U.S. "will continue to be a helpless victim of other countries' auto policies."[21]

Supporters envision other advantages from domestic content laws. Stating that "a local content requirement would cause a minimum of disruption in ordinary channels of trade," the Business Week editorial predicts increases in U.S. employment without eliminating the profits of Japanese firms or prohibiting U.S. consumers from buying the kinds of cars they want.[22]

The UAW adds that a domestic content law would encourage more competition among manufacturers by bringing more automakers into the U.S. Business Week foresees intense competition among U.S. suppliers for the Japanese firms' parts business. Thus, it is argued, incompetent, high-cost firms would not be protected under these laws as they would with tariffs or import restrictions.[23] In addition, U.S. producers are expected to continue to be disciplined by the designs and emerging innovations of foreign based producers.[24]

Finally, proponents argue that the fear that producers will be unable to achieve plant size and output necessary to reach economies of scale is unfounded. H.R. 5133 and S. 2300 allow producers to receive credit for parts or vehicles exported to offset imported items. Thus, it is claimed, sufficient size for efficient production will be possible.[25]

Many question the rosy picture painted by the bill's supporters. In the first place, many analysts do not place the primary blame for the recent poor performance of the auto industry on imports. Most notably, the U.S. International Trade Commission (ITC) studied the auto industry in 1980. The ITC concluded that imports represented only a small part of the industry's problem. Higher gasoline prices and the resulting demand for smaller, more fuel efficient cars allowed the Japanese to gain a temporary advantage in the U.S. Domestic manufacturers were, at the time, unable to meet the demand for compact cars. This gap, however, is being closed rapidly.[26] U.S. automakers have begun paying unprecedented attention to quality and productivity. As a result, domestically produced small cars have gained more from recent shifts in consumption patterns than foreign cars have. Explains one analyst: "The Japanese themselves are concerned about the coming competition....Silhouetted against two-ton behemoths, the

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20 "A Better Way to Handle Auto Imports," Business Week, April 13, 1981.

21 Fraser, op. cit., p. 10.

22 "A Better Way to Handle Auto Imports."

23 Ibid.

24 Fraser, op. cit., p. 8.

25 Ibid., p. 6.

26 Heeter, op. cit., p. 5.

Japanese models look clever and economical; compared with a new generation of space-efficient front-wheel-drive cars, they are cramped and anachronistic."[27]

The ITC concluded that the recession and continued high interest rates combined with falling real discretionary income for American households and consumer pessimism have had the most significant impact in reducing U.S. auto sales and keeping them low.[28] Furthermore, the rapidly rising cost of automobiles (or "sticker shock") in 1979 and 1980 was cited as a factor in the overall decline of car sales.[29]

Many observers feel none of the U.S. auto producers could meet the requirements of the content legislation as it is now written. This is in part due to the very narrow definition of North American content in H.R. 5133 and S. 2300, but is also the result of increasing reliance by American manufacturers on worldwide sources. Douglas Fraser admits that "[M]any of the steps the U.S.-based auto multinationals will be taking to improve their competitive positions could cause <u>further</u> widespread unemployment and continued erosion of the nation's industrial base."[30] (Emphasis in original.) While the U.S. automobile industry has made great strides to become internationally competitive, many observers fear domestic content laws would greatly inhibit, if not reverse, this welcome development.

Confronted with the enormous cost of developing a smaller, more fuel-efficient car, the need to conserve capital resources, and the lower production costs in many foreign countries, American producers have sought more foreign sources for components for U.S.-made autos. Foreign firms, after all, have the experience in producing parts for smaller vehicles. Ford, Chrysler, and American Motors, in particular, save considerable time and expense by purchasing small engines and transmissions abroad rather than developing and producing them domestically. In fact, one industry analyst has questioned the ability of Ford and Chrysler to tool up and build the components they now import should the domestic content legislation become law. General Motors is also taking advantage of foreign expertise, buying 400,000 diesel engines from Isuzu. GM probably has the financial resources to produce the engines, but feels it lacks the engineering time and talent to accomplish the task quickly enough.[31]

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27 <u>Ibid.</u>, p. 6.

28 "Domestic Content Laws: Rx for a Permanently Non-Competitive Industry," p. 7.

29 Statement of Ambassador David R. MacDonald, Deputy U.S. Trade Representative, before the Subcommittee on Commerce, Transportation, and Tourism of the House Energy and Commerce Committee, March 2, 1982, p. 2.

30 Fraser, <u>op. cit.</u>, p. 15.

31 Nanto, CRS <u>Report</u>, p. 15.

Furthermore, Fraser's allegation that U.S. auto producers are planning an even greater reliance on foreign sources is well-founded. Some industry observers predict that U.S. manufacturers will import up to 25 percent of their parts by 1985 and 35 percent by 1990.[32] This may be necessary if American producers are to minimize costs and compete on a worldwide basis.

The ability of automakers to compete in an international market will become more crucial in the future. In the first place, the U.S. market for automobiles is a mature one. Population size is relatively stable and income levels are such that most people who want a car already own one. Manufacturers, therefore, cannot expect much more growth in the U.S. market.

On the other hand, incomes in other countries are still rising. The average household income in Europe and Japan has caught up to that in the U.S. only recently. The markets with growth potential, thus, are overseas. With American gasoline prices now at world levels, consumers world wide are demanding cars of about the same size and design. As a result, U.S. automakers are interested in manufacturing cars that can be sold and produced in many markets. GM's J-cars, for example, are produced in nine countries.[33] Domestic content laws would severely harm the ability of American automobile manufacturers to compete in this international market.

First, U.S. firms are, unfortunately, required to invest abroad to meet the local content requirements of other nations. For these plants to achieve an efficient size, some of their output must be exported.[34] Stringent U.S. domestic content requirements would severely limit automaker's ability to achieve economies of scale in these plants.

Second, while some overseas investment is forced, some is clearly voluntary. The natural tendency of producers to minimize costs implies that forcing them to relocate these plants in the U.S. would increase their costs of production. GM, for example, is convinced that worldwide sourcing permits cost-effective, efficient production.[35]

Third, because of the need to relocate these plants in the U.S. or Canada, domestic content requirements would aggravate the demand for already scarce financial capital among U.S. firms.[36]

These considerations led the Wall Street Journal to conclude that local content requirements "would deliver a knock-out punch

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32 Ibid., p. 7.
33 Ibid., p. 6.
35 Ibid., p. 15.
35 Ibid., p. 16.
36 FTC Letter, p. 2.

to GM's and Ford's 'world car' strategies of consolidating international production and gaining access to the highest quality, lowest cost engines and parts."[37]

Reduced flexibility to use foreign sources is not the only cost increase. The bookkeeping required for compliance with the law would be considerable. Unlike the case of emissions and safety certification, the local content of most vehicles could not be certified in the prototype stage. High volume models are manufactured at different plants throughout the U.S. and often have different sources for the same equipment. In addition, suppliers are sometimes changed during the model year.[38] Extensive record keeping by the manufacturers would have to be coupled with detailed reports from parts suppliers to avoid "laundering" of foreign produced parts through U.S. firms.[39]

If foreign manufacturers decide to reduce their sales in this country rather than make the necessary investment here, competition will be contracted significantly. Incentives for continued investment and productivity advances would fade. The Detroit News worries that "local content legislation [would] merely set in concrete incentives for inefficiency."[40] A significant reduction in competition from foreign firms, moreover, would raise serious questions about the degree of competitiveness among American automakers. Antitrust investigations would follow.

No one argues that a domestic content law would increase profits for U.S. auto parts suppliers. But, if the law reduced the ability of American auto manufacturers to compete internationally, greater profitability for suppliers might be offset by reduced profitability among automakers.

EFFECT ON CONSUMERS

The UAW and others supporting domestic content laws assume Japanese manufacturers will build plants in the U.S. in an effort to maintain current sales levels. Based on this assumption, proponents believe the U.S. consumer will suffer neither significantly higher prices nor reduced selection. Fraser notes that Volkswagen faces no substantial cost disadvantage by producing in the U.S., and there is at least some evidence that the quality of Rabbits produced in this country exceeds that of the European produced cars.[41]

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37 "Detroit, Argentina," Wall Street Journal, April 28, 1982.
38 FTC Letter, p. 3.
39 Nanto, CRS Report, p. 17.
40 Detroit News editorial, March 3, 1982.
41 Fraser, op. cit., p. 15.

Supporters further argue that if automobile and light truck prices do rise slightly, it is only what is needed to restore profits and provide funds for capital investment.[42] Thus, the UAW and others behind the legislation claim content requirements will be equitable to consumers while ensuring that the money from automobile sales stays in the U.S. and benefits the American economy.[43]

Critics of the bill disagree with these rosy predictions. They note that while it may be true that VW faces no substantial cost differences between its U.S. and European plants, the same may not hold true for Japanese manufacturers. The inevitable increase in production costs caused by forced relocation will lead to higher automobile prices for the U.S. consumer.[44]

Because opponents of the content requirements believe foreign manufacturers will be unable or unwilling to make massive investments here, there will be fewer models from which to choose, and the shortages of various models will result in a "scarcity premium" driving up prices further.[45] The Department of Commerce has suggested that auto prices would rise by 10 percent or more.[46] A 1980 study by the Council of Economic Advisors estimated that limiting imports to 10 percent of the U.S. market would raise car prices from 13 to 17 percent.[47]

A Federal Trade Commission study examined the potential impact of reducing imports from 2.4 to 1.7 million annually--a less restrictive proposal than that mandated by the domestic content bills. The FTC report concluded that auto prices would increase between \$527 and \$838 per unit.[48] American International Automobile Dealers Association President Robert McElwaine predicts an even greater price hike. He sees consumers paying \$850 to \$3,000 more per automobile.[49]

These higher price tags mean that consumers will be paying a great deal to generate jobs for autoworkers. One study concluded that, for every job generated in the automobile industry at \$20,000 per year, consumers would pay \$80,000 to \$90,000 in higher prices.[50] Other estimates are higher. Administration estimates predict that every job gained in the auto industry

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42 Nanto, CRS Issue Brief, p. 6.
43 Samuel, op. cit., pp. 6-7.
44 Nanto, CRS Report, p. 16.
45 Ibid., p. 17.
46 "Administration's Position on Local Content Legislation (H.R. 5133 and S. 2300)," June 18, 1982.
47 Heeter, op. cit., p. 13.
48 FTC letter, p. 2.
49 Statement of Robert M. McElwaine, President, American International Automobile Dealers Association, June 9, 1982.
50 Heeter, op. cit., p. 13.

would cost the American economy $100,000.[51] Other studies claim that the cost to the economy of reemploying an autoworker under the current voluntary import restrictions ranges from $245,000 to $1,125,000. The proposed domestic content law could cost more.[52]

Ironically, autoworkers are among the highest paid American workers. Their wages are currently 28 percent above the average for all manufacturers.[53] With domestic content laws in effect, the average manufacturing employee earning $7 per hour would be required to subsidize autoworkers earning a $9.50 hourly wage.[54] In addition, with the removal of effective international competition to apply downward pressure on car prices, the UAW could continue to extract wages significantly in excess of the average for manufacturing.[55]

Supporters of the domestic content bills seem to assume that demand for automobiles will remain constant. This is unlikely. For one thing, if Americans are indeed suffering from "sticker shock," even a minor increase in prices will reinforce the trend to drive cars longer or buy used rather than new cars.[56] Thus, demand will be further reduced. In addition, the domestic content bills send a very negative message to the American consumer about the quality of U.S.-produced automobiles vis-a-vis foreign cars. It may be interpreted as an admission that American vehicles are unable to compete without the government's help in forcing their purchase.

IMPACT ON OTHER U.S. EXPORTERS

A domestic content law for the automobile industry could cause problems for other U.S. exporters. One of the most important considerations should be the effect of this legislation on international agreements now in force.

In testimony before Congress, Ambassador David R. MacDonald, Deputy U.S. Trade Representative, expressed concern that passage of the domestic content bills would violate the General Agreement on Tariffs and Trade (GATT). MacDonald noted that the establishment of specific minimum domestic content quotas directly conflicts with requirements in GATT Article III. This article states, in

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51 Summary of Administration's position, p. 1.

52 "Domestic Content Laws: Rx for a Permanently Non-Competitive Industry," p. 6.

53 Ibid.

54 Heeter, op. cit., p. 13.

55 Oral testimony by Robert M. McElwaine, President, AIADA, before the Subcommittee on Commerce, Transporation, and Tourism of the House Energy and Commerce Committee, March 2, 1982, p. 148.

56 Ibid., p. 146.

part, that no contracting party to GATT "shall establish or maintain any internal quantitative regulation...which requires, directly or indirectly, that any specified amount or proportion of any product...must be supplied from domestic sources."[57] In other words, domestic content laws are outlawed.

Ambassador MacDonald further noted in his testimony that the sanctions of the domestic content bills place strict limitations on the number of automobiles that may be imported by manufacturers who do not meet the local content requirements. This represents a violation of GATT's Article XI which prohibits the use of quotas to limit imports.[58]

Finally, the special consideration given Canada under the proposed legislation violates the most-favored-nation requirements of the Agreement. "[A]ny advantage, favor, privilege or immunity granted" to the products of one country must be accorded to similar products from all other contracting countries.[59]

GATT does contain methods through which these provisions can be circumvented--primarily Article XIX, the escape clause. This section allows a nation to suspend GATT obligations in whole or in part when imports seriously threaten domestic producers. Normally, a country invoking the escape clause is expected to compensate injured countries by granting trade concessions for other industries.[60]

Assuming the escape clause is invoked by the U.S. and agreed to by the other signatory nations, compensation may be sought--particularly by Japan. Certain industries are considered especially vulnerable. The computer, aircraft, telecommunications equipment, semi-conductor, and agricultural industries, for example, suddenly might face substantially increased competition abroad.[61]

For U.S. automakers, however, use of the escape clause would prove difficult. As the International Trade Commission concluded, imports are not substantially injuring U.S. automobile producers. U.S. automotive parts suppliers, moreover, have been consistently denied trade adjustment assistance because they have been unable to show that imports contribute significantly to worker layoffs and declines in sales.[62]

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57 MacDonald testimony, p. 6.

58 Ibid., p. 7.

59 Ibid.

60 Nanto, CRS Report, p. 10.

61 See, for example, Letter from Ambassador William E. Brock, U.S. Trade Representative to Representative James H. Scheuer, June 9, 1982; Heeter, op. cit., p. 11; or Summary of Administration's Position, p. 3.

62 Nanto, CRS Report, pp. 10-11.

Given the difficulties of invoking the escape clause and the problems with agreement on compensatory trade adjustments for producers in nations harmed by the proposed domestic content laws, retaliation becomes a possibility. While expressing sympathy with the basic goal of encouraging investment by foreign manufacturers in the U.S., Senator John Heinz (R-PA) cautions: "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."[63] In fact, existing domestic content requirements abroad, and those that might arise in retaliation for a similar U.S. law, directly threaten the U.S. auto parts industry--one of the primary supporters of H.R. 5133 and S. 2300. The U.S. auto parts industry exports amounted to $3.9 billion in 1980 ($8.8 billion, if exports to Canada are included).[64]

Many of the bills' opponents fear that the present support for liberal worldwide trade is too fragile to withstand a major domestic content law in the U.S. Some analysts predict that such a move by the U.S. could set off a series of protective actions and reactions around the world.[65] This would represent a step back toward the disastrous "beggar-thy-neighbor" trade policies that contributed to the depression of the 1930s.

Not surprisingly, the UAW and others supporting the domestic content bills disagree with this assessment. Proponents deny that a trade war would result. They admit the proposed law is directed primarily at Japan, but point out that other countries are at least minimally affected. Supporters argue that trade problems with Japan have existed for some time. The Japanese government restricts imports of beef, citrus fruits, and cigarettes, for example, thus already violating a number of GATT provisions.[66] It is argued that Japan will be unwilling to seek compensation and open its government to countercharges by other signatory nations. Proponents, therefore, predict there will be no challenge of U.S domestic content laws under GATT. In support of this assertion, Fraser notes that none of the domestic content requirements in thirty other countries has been challenged under GATT, nor have they been the cause of serious trade friction with Europe or Japan.[67]

Proponents argue finally that domestic content laws would give the U.S. trade negotiators leverage in bargaining to reduce barriers to U.S. exports in other countries.[68] Ironically, this

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63 Ibid., p. 14.

64 "Detroit, Argentina."

65 See, for example, Heeter, op. cit., p. 12; "Domestic Content for Autos?" World Trade Outlook, Vol. 4, No. 3, 1982, p. 8; or MacDonald testimony, p. 9.

66 Fraser, op. cit., p. 11.

67 Ibid., p. 8.

68 Nanto, CRS Issue Bulletin, p. 7.

push for a domestic content law closely followed a statement issued by Ambassador William Brock, U.S. Trade Representative, explicitly calling for a removal of foreign domestic content requirements. Opponents of the legislation fear the existence of U.S. requirements would undermine efforts by the U.S. delegation at upcoming trade talks to negotiate reduction of trade barriers. Ambassador Brock has expressed opposition to H.R. 5133 and S. 2300. In a letter to several Representatives, Brock called the proposed domestic content laws "blatantly inconsistent with our international commitments," and "the worst threat to the international trading system and our own prosperity to be put before Congress in a decade." He further notes that, if enacted, the legislation "would undermine the current drive by the United States to open foreign markets more fully to our products and would damage the international trading system to such an extent that less world trade and fewer jobs would be the eventual outcome."[69]

Even if retaliation does not develop to the extent expected by many, U.S. exports of other goods still may suffer. Artificially reducing imports means fewer dollars flow overseas, giving foreigners fewer dollars with which to buy U.S. goods. Given a system of floating exchange rates, the U.S. dollar then appreciates, making U.S. goods relatively more expensive overseas. Other things equal, imports thus would tend to increase and exports to decrease.[70]

In short, through retaliation, compensation, or the appreciation of the dollar, domestic content laws might well force non-automotive industries to pay for the UAW's content rules through intensified domestic competition from abroad or the loss of markets overseas.

And if the domestic content bills are passed for the automobile industry, representatives of other sectors soon will be making similar requests. Arguments similar to those made by the UAW could be made for several industries--especially if the automobile content requirements have the effects predicted by most analysts. If Congressmen continue to lend credence to these arguments, the end result could be a substantial reduction in world trade.

THE JOBS QUESTION

A number of predictions have been made about the impact of a domestic content requirement on jobs in the economy. By far, the most optimistic is that of the UAW. Fraser told Congressmen that

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69 U.S. Trade Representative letter.
70 Nanto, CRS Report, p. 14.

a local content law would create 868,000 auto and auto parts supplier jobs in the U.S. by 1985.[71]

In arriving at this prediction, a UAW study assumes that in the absence of content requirements the market share of imports will increase to 35 percent by 1985 and the foreign content of American automobiles will rise from 3 percent in 1981 to 10 percent in 1985. The proposed domestic content law, the UAW argues, would keep imports at 25 percent of the U.S. market, and those imports are expected to contain 59 percent U.S. content.[72] Based on these assumptions, the UAW estimates that the four U.S. automobile producers would employ 117,000 more workers by 1985 than they would in the absence of content requirements. Investment in the U.S. would lead foreign manufacturers to employ 146,000 more workers according to the UAW model. Using Bureau of Labor Statistics data which indicate there are 2.3 supplier jobs supported by every one job in automobile manufacturing, the UAW estimates 605,000 jobs would be generated in the supplier industries. Thus the assertion that 868,000 jobs would be created.[73]

The UAW estimates have been widely criticized. A newsletter published by the American International Automobile Dealers Association (AIADA) notes that the UAW's claim is dependent on the assumption that foreign manufacturers will make the investments necessary to produce domestically the same number and model mix of cars they now import. The UAW apparently considers neither that foreign built plants might be more automated than U.S. plants nor that Japanese producers might decide to reduce imports. Either of these situations could significantly reduce the number of jobs created. Furthermore, the AIADA newsletter notes that UAW estimates for gains in U.S. employment among American producers represent the number of jobs that would be saved by preventing domestic firms from obtaining more components abroad. To claim these jobs would be "created" is, AIADA argues, misleading.[74]

A Congressional Research Service Issue Bulletin also questions the UAW estimates. First, Dick Nanto, author of the Issue Bulletin, examines the conclusion that 117,000 jobs will be generated among U.S. firms by holding their foreign content at 6 percent rather than 10 percent. Using a "normal" employment figure of 700,000 workers,[75] Nanto estimates that this 4 percent content saving would result in 28,000 jobs among the domestic producers. Using an estimate of 2.2 jobs in supplier industries for every auto

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71 Fraser, op. cit., p. 7.

72 Nanto, CRS Issue Brief, p. 2.

73 Fraser, op. cit., p. 7.

74 American International Automobile Dealers Association Newsletter, Vol. XII, No. 6, June 30, 1982, p. 2.

75 In 1978, considered the last "normal year," American automobile producers employed 760,000 workers.

worker's job, Nanto predicts 61,600 jobs would be created among suppliers. Nanto suggest the discrepancy between his numbers and those of the UAW is a result of the union's supposition that the market share of imports will rise to 35 percent without a content requirement. Many forecasts predict, however, that the import share will fall, not rise, in the future.[76]

Secondly, Nanto produces a lower estimate for the number of jobs that would be generated by substituting U.S produced vehicles for imports. Under Nanto's assumptions, imports would be reduced by 1.58 million units. Supposing the demand for domestically produced vehicles increased on a one-for-one basis, there would be 1.58 million more cars produced domestically. On average, output of 15 automobiles generates one job, so that employment would increase as a result of the import restrictions by about 105,000 jobs. Using the assumption that 2.2 jobs are supported in the supplier industries by each job in the automobile plants would lead to an estimate of 231,800 indirect jobs being generated.[77]

Thus, Nanto's estimates lead him to conclude that a maximum of 133,000 jobs would be created or saved in the auto industry and 293,400 jobs in the supplier industries. Total employment gains would, then, be at most around 426,000.[78]

Nanto's numbers are corroborated by an examination of recent experience in the industry. Since 1978, domestic automaker output has fallen by about 3 million units--resulting in the indefinite layoff of approximately 250,000 workers. (The number of imports has remained fairly constant.) Shifting the production of 1.58 million vehicles to domestic producers should, then, lead to the rehiring of slightly more than half of those laid off--133,000 by Nanto's estimates.[79]

These predictions are, however, optimistic. They assume a one-for-one transfer from imports to domestically produced automobilies--something unlikely to happen if prices rise substantially or consumers receive a negative message about American automobile quality from the proposed law. Furthermore, these estimates take no account of foreign investment in the U.S. in the absence of a domestic content law. Volkswagen is increasing its production capacity in its U.S. facilities. Honda plans to begin production soon in Ohio, and Nissan (Datsun) is building a plant in Tennessee that will produce 156,000 light trucks beginning in late 1983. Other investments are currently in the planning stages.[80]

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[76] Nanto, CRS Issue Brief, p. 3.
[77] Ibid.
[78] Ibid.
[79] Ibid.
[80] Ibid., pp. 3-4.

These and similar considerations have led the Department of Commerce to estimate that possible job gains in the automotive and supplier industries would be no more than 110,000 to 200,000. In a letter to Representative Dingell, Secretary of Commerce Malcolm Baldrige notes that the Council of Economic Advisors estimates that a doubling of U.S. auto sales by 1985 would result in no more than 200,000 jobs in the auto sector.[81]

An even more important criticism is that the UAW figures fail to consider the jobs that will be lost as a result of domestic content requirements. Robert McElwaine, President of AIADA, predicts that the domestic content bill would close a minimum of 2,000 import dealerships, resulting in unemployment for 80,000 workers.[82] Furthermore, reducing imports jeopardizes jobs at the nation's ports. Darrell Trent, acting Secretary of Transportation, estimates that up to 11,600 direct jobs and 81,200 indirect jobs would be endangered in fourteen East, West, and Gulf ports.[83]

Jobs in other sectors may also be jeopardized. Baldrige notes that one out of seven U.S. jobs and one of three farmland acres are dependent on exports.[84] In fact, the jobs of some of the 200,000 UAW members employed in the agriculture equipment industry could be in danger.[85] In sum, if the content bills were to result in retaliation, the economy as a whole could easily lose more jobs than would be gained.

CONCLUSION

Domestic content bills for the automobile industry--H.R. 5133 and S. 2300--have been introduced in Congress in response to the success that Japanese auto manufacturers have experienced in the U.S. and the growing tendency of American firms to establish worldwide production. They are designed to protect the jobs of a particular group within the country--the workers in the auto and auto supply industries.

The UAW makes many claims in support of local content. Few other analysts make the same predictions. Most of the differences in opinion hinge on assumptions about the Japanese reaction--will they make the substantial investments anticipated by the act or will they reduce sales in this country and pursue compensation under GATT?

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81 Letter from the Secretary of Commerce Malcolm Baldrige to Representative John Dingell.

82 McElwaine statement, p. 2.

83 Secretary of Transportation letter.

84 Remarks by Secretary of Commerce Malcolm Baldrige before the Chamber of Commerce Session on Local Content Bills, June 29, 1982, p. 3.

85 Heeter, op. cit., p. 12.

If Japanese firms do substantially reduce sales in this country rather than produce here, the American automobile market will become effectively closed. Prices will rise. Costs for American producers will climb as they are forced to relocate in the U.S. and as the autoworkers push for more wage concessions from their monopoly position. No longer will there be downward pressure on prices from abroad--or any effective incentive for U.S. manufacturers to pursue further gains in efficiency. Consumers will suffer not only from considerably higher prices, but also from a much narrower range of selection when choosing a new car.

For all of this, American automobile manufacturers will not necessarily be placed in a better position. Forced relocation and expected retaliation may make it difficult for U.S. firms to continue expanding in overseas markets. Perhaps the most significant statement about this bill is that the U.S. producers have <u>no</u> official opinion on it. They do not oppose it, but neither do they support the proposed law. Surely if auto manufacturers expected domestic content to be the panacea promised by the UAW, they would be out in full support of the legislation.

The employees of automobile import dealerships stand to lose, as will those companies handling their advertising and servicing. Individuals involved with the shipping of these imported vehicles around the country also will lose--those working at the ports as well as truckers. Beyond those workers directly involved with selling foreign automobiles in this country, employees of other industries may be hurt. If Japan decides to take action--either formally or informally--against U.S. exports, other industries will suffer. Even without retaliation, employees of other export related industries stand to lose. Artificially reducing Japanese automobile imports means that the dollar will appreciate overseas--making U.S. goods relatively more expensive on the world markets.

In fact, the only clear winners under this proposal would be the autoworkers. With a strong domestic content law, autoworkers would have more power in negotiations with manufacturers and fewer worries about losing their jobs to outside competitors.

Even if some of the specific problems with the bill are resolved--exactly how domestic content will be defined, for example, or the effective "punishment" of firms already investing in the U.S.--problems remain with the very existence of this sort of market barrier. There is always a hefty price to pay when government erects obstacles in the marketplace. A domestic content law would be an enormous obstacle whose net effects for the economy almost certainly would be higher prices, perhaps reduced employment opportunities, and less choice for consumers.

Catherine England
Policy Analyst