The Heritage Foundation Backgrounder

No. 288 | The Heritage Foundation 214 Massachusetts Avenue N.E. Washington, D.C. 20002 (202) 546-4400

September 1, 1983

# THE GM—TOYOTA JOINT VENTURE

## INTRODUCTION

In February 1983, General Motors Corporation and Toyota Motor Company of Japan announced a joint venture plan to co-produce a small, front wheel drive auto in a plant vacated last year by GM in Fremont, California. According to the agreement, the two companies will produce a car comprised of a Japanese engine and transmission and a U.S. body. The name of the new car, which will be marketed by Chevrolet, has not been decided. It will not replace any existing GM or Toyota car.

The two companies together plan to invest $300 million in the project, including the $130 million plant that GM still owns. According to GM and Toyota projections, the project will create 12,000 new jobs in the U.S.--3,000 in the production process and 9,000 in supplier and related industries spread throughout the U.S.

Fremont, California, is enthusiastic about the venture. Public opinion in California and the rest of U.S. is also highly favorable. The United Auto Workers support the project, even though Toyota is resisting hiring on the basis of seniority UAW workers laid off after the GM plant closed and the joint venture company will utilize Toyota production techniques that include "versatile" workers (who perform two or more jobs)--a practice not allowed in UAW plants in the U.S.

Apparently only Chrysler and Ford oppose the project, charging that it violates anti-trust legislation. They also contend that it will cost more jobs than it creates, since the car built by the new plant will compete with other U.S. made cars. The Federal Trade Commission is expected to rule on the anti-trust issue in September.

*Note: Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.*

The project appears to offer important benefits. It will give the U.S. auto industry, as well as the United Auto Workers, some direct lessons in Japanese management techniques, labor-management relations, and technology. It also promises to defuse the domestic content movement and efforts to continue "voluntary" quotas on Japanese cars--both of which would be detrimental to free trade and the competitiveness of the U.S. auto industry.

Hence, the criticisms seem unjust. Not only do Chrysler and Ford seem to be afraid of competition, but the charges of anti-trust violations seem to have little basis in fact. Indeed, the joint venture will excite competition. It also promises to help the American consumer by putting another quality, economical, and clean car in the marketplace.

## SITUATION IN THE U.S. AUTO INDUSTRY

The Toyota/GM joint venture must be seen in the context of a still seriously troubled U.S. auto industry. During 1980-1982, several hundred thousand, nearly one quarter of U.S. auto workers, were laid off--50,000 by Chrysler in 1981 alone. During the slump, U.S. auto manufacturing plants operated at under 60 percent capacity. At this same time, foreign auto companies captured 30 percent of the U.S. market.

Recovery has changed this situation only slightly. Lower interest rates and a stronger economy have helped. But the U.S. auto industry is not back on its feet. Few workers laid off are back working. Closed plants remain closed. And the auto recovery would not be what it is were it not for the fact that there is still an import quota on Japanese cars.

In fact, the main problem for U.S. auto companies is competition from Japan. Of the 30 percent penetration of the U.S. market, Japanese cars account for around 27 percentage points. American buyers originally took to Japanese cars because of their lower price. Then it was fuel economy. Now it is quality or value purchased. Independent testing services such as Consumer Reports give virtually all Japanese cars sold in the U.S. excellent ratings in terms of quality: frequency of repair, resale value, and integrity of body. No American car gets an excellent rating. Studies indicate that Japanese manufacturers can make the same car as U.S. companies for $1,000 to $1,500 less. Other estimates range as high as $2,500.

### Sources of the Trouble

There are three reasons for the higher cost and lower quality of American cars: labor, government and management. Of the $1,000 to $1,500 savings in production that Japanese manufacturers have over American companies, one half is the cost of labor. This is not because labor is cheaper in Japan. In the auto industry, however, American labor is more expensive--more than half again

Japanese labor. In short, labor in the U.S. auto industry is overpaid. In 1981, auto workers were paid 70 percent above the average of nonagricultural industries.

Moreover, Japanese auto manufacturing companies use less labor. Japanese plants are located more rationally, closer to raw material supplies and markets. U.S. companies are located inland, requiring more expensive land transport. New companies are located for reasons of reducing unemployment or hiring minorities. And unlike the U.S., Japanese unions do not oppose automation or robotization. Japan has two to three times more robots in manufacturing than the U.S.

Also crucial is the quality of labor. Japanese companies stress quality control, which they maintain in Japan in large part through excellent labor-management relations. This is much more difficult in the U.S.

Government red tape is also a serious problem. Chrysler argued that its financial crisis could be explained totally in terms of the cost incurred by the company to comply with government regulations, pay taxes, and Social Security. All American auto companies note that exporting is cumbersome and that it is more difficult for them to export than for American distributors of Japanese auto companies to import. While the Japanese government does not subsidize the exports of Japanese cars, as some contend, it helps business rather than impeding or harassing it and generally gives greater assistance to large, dynamic exporting companies than to small, nonexporting firms.

U.S. auto companies have been forced to diversify to survive. They have also been impelled to invest in foreign auto companies and import cars from Japan or build manufacturing plants abroad to remain competitive.

Hence American companies are unable to compete--in the U.S. or abroad. In 1979, fewer than 200,000 American made cars were sold overseas (ironically, nearly ten percent of them in Japan). Only Saudi Arabia and Kuwait purchase more U.S. made cars than cars manufactured elsewhere. U.S. auto companies based abroad are doing well, but are hurt by the bad image of U.S. cars at home and the financial condition of the parent company. Since 1979, America's share of the world market has dwindled. U.S. companies appear to have no hope of getting a meaningful slice of the 1980s world market, estimated at 41 million units of passenger cars alone. Meanwhile, Japanese companies are daily expanding in the international market.

<u>Current Solutions</u>

One of the solutions frequently cited to deal with the U.S. market side of the problem is a local or domestic content bill

requiring that all automobiles sold in the U.S. contain a certain percentage of American-made parts. Such a bill was sponsored by Representative John Dingell (D-MI) and recently passed the House. It is doubtful, however, whether the bill can muster sufficient support to pass the Senate or to override an almost certain presidential veto.

Such a bill would protect the U.S. auto industry in a way that would ultimately make it non-competitive. The bill would hurt the consumer, and it would, no doubt, have an adverse effect upon both the energy and the environment. This kind of protectionism would destroy any hope of American-made cars competing in the international marketplace.

Another alternative is a quota--voluntary or otherwise. In fact, a voluntary quota is now in effect. Japan's Ministry of International Trade and Industry (MITI) reluctantly agreed in April 1980 to a quota of 1,680,000 units a year.

Quotas generally do not work and this one is no exception. Limiting the number of autos that Japanese manufacturers can export to the U.S. prompted Japanese companies to send a greater percentage of larger, more expensive cars to the U.S. Thus, Japan proved that not even large American cars are competitive. Also, Japanese companies now are making a larger share of the profits in the U.S. with the same volume--profits U.S. companies need for investment in research and new machines. In addition, Japanese cars are putting still more U.S. workers out of a job because more labor goes into bigger, more luxurious cars. Finally, since Japanese companies are exporting fewer smaller cars to the U.S., energy and environmental problems are made more acute.

Continuing quotas will interfere with the market forces and protect U.S. auto companies at a time when they should not be, and cannot be, realistically protected. Moreover, when President Carter announced the "voluntary" quota on autos, he indicated that it was not binding. The new MITI head recently said that he sees no reason to continue it for a fourth year. If sales of Japanese cars are restricted and U.S. automakers do not produce a better product--which, history teaches, they will not do if protected--South Korea, Taiwan, and other countries will simply enter the market. In the meantime, U.S. agricultural and other industries exporting to Japan would suffer--punished even though they are efficient.

## THE TOYOTA-GM VENTURE AS A LEARNING EXPERIENCE

Two Japanese companies--Honda and Nissan (Datsun)--have already set up manufacturing operations in the U.S. The former has a plant operating in Ohio; the latter is completing assembly works for small trucks in Tennessee. Both are basically new operations. Both are nonunion. Honda and Nissan will be run by Japanese managers and could become models for U.S. companies to follow.

Many of the workers in these plants are being sent to Japan for training in Japanese management techniques.

So far, both operations see considerable hope of success. On the other hand, they have created some problems. Japanese management techniques cannot easily be adopted in the U.S. The plants are seen as anti-union, taking advantage of cheap labor and beneficial work laws in certain sections of the U.S. Finally, the plants are located where they are because of special advantages offered by the state governments involved.

Toyota long has resisted setting up operations in the U.S. for fear of sullying its reputation for quality products--generally the best among cars sold in the U.S. Volkswagen of America has experienced this problem, though not so noticeably because of a parallel deterioration in quality at their German plants. Honda now seems to be facing the same situation. This explains why Toyota rejected a deal with Ford some months ago and why, in the case of the proposed joint venture agreement with GM, Toyota is not putting its name on the final product. In short, Toyota's motivation is coping with the threat of domestic content legislation and extended quotas.

The deal offers some important advantages to the U.S. auto industry in terms of learning how to build a good car--advantages that the Honda and Nissan plants do not offer. First, the plant will be unionized from the outset. There will be no fighting to make it a union shop. The United Auto Workers have already accepted the fact that they must make some concessions--mostly in terms of maintaining labor discipline to hold up quality control. Thus, they have basically agreed to the new plant rehiring laid-off workers on the basis of work commitment and quality rather than seniority. They have also promised stiffer work rules and will allow management to discipline workers who consistently are late, slothful or impede productivity and quality management--or the union will take care of these problems itself.

The plant will import from Japan parts which Toyota produces more cheaply and where quality is the highest--engines and transmissions. Robots will take up some of the slack in keeping quality in body integrity and evenness in fitting parts together. The plant will be located rationally near the market, rather than close to the steel industry, or in Detroit, where the U.S. auto industry has been by tradition. Some parts of the car will come from either Japan or the U.S. depending on price and quality--thereby fostering keen competititon in parts manufacturing.

Only one type of car will be produced in the plant: a front wheel drive, subcompact car. Since Toyota is working on new types of engines for its front wheel subcompacts, including ceramic engines which will be much lighter, cheaper to build, and capable of increased fuel efficiency and less pollution, future improvements can probably be made in the auto quickly and cheaply.

Toyota will pick the chief operating officer, since he will be responsible for the machines used in the assembly process and the engineering of the car. GM will occupy half of the Board of Directors seats, since it will provide half the investment, and will market the car through existing Chevrolet dealerships.

To ensure that the joint venture does not endanger competition in the auto industry, the agreement is limited to the production of one type of vehicle, at one facility. Also, the agreement has a termination date--1995. The number of cars produced annually will not exceed the 200,000 now planned. Future expansion will be up to General Motors.

## CRITICISMS OF THE PROJECT

Nevertheless, both Chrysler and Ford have assailed the agreement as, in the words of Chrysler's Lee Iacocca, "fundamentally bad." Both companies feel that the agreement will threaten competition in the U.S. car market since it will involve a "merger" of the world's number one and number three auto makers. In other words, Chrysler and Ford are accusing Toyota and GM of anti-trust violations, in spite of the precautions taken and the severe limits in the agreement. Iacocca also contends that the venture will cost the U.S. two jobs for each one it will provide.

These criticisms seem shallow. First, since 1970, Chrysler has owned 15 percent of Mitsubishi Motors of Japan and has exclusive rights to market specific Mitsubishi autos in the U.S. Mitsubishi Motors is connected to a parent company which is one of Japan's largest combines and, in terms of both assets and sales, is much larger than Toyota. The ties go further: Mitsubishi supplies Chrysler engines for its K cars, has purchased outright Chrysler Australia, and is financing the exports of its cars to Chrysler in the U.S. to help Chrysler through its financial crisis.

Second, Ford, in the 1970s, purchased one-fourth of the stock of Mazda--now Japan's third largest auto maker. Ford still owns stock and is the beneficiary of huge increases in the stock prices of the company--helping, of course, to keep Ford afloat during hard times.

Third, the argument that the project will cost as many jobs as it will create is probably not credible. The car will compete with foreign cars more than U.S. cars. This is particularly true since it will find its best market in California where the percentage of foreign cars, especially Japanese cars, is considerably higher than the national average. The proportion of foreign cars that are subcompacts there is also greater. This is further evidence that it will compete with imported cars, including the Japanese imports sold by Chrysler and with the Chrysler K Car, which is essentially a mixed breed--a U.S. car with Mitsubishi or Volkswagen engine (like the yet to be named Toyota-GM car.) It is unlikely, moreover, that United Auto Workers leaders would have approved the deal if it were to cost American jobs.

The effect on unemployment in the U.S. is, in fact, difficult to predict at this time. The new facility will hire workers from the GM Fremont plant and some from a Ford plant also closed in California this year. Parts companies nearby and elsewhere in the U.S. will benefit. Even more employment will be created if the experience is a good one for Toyota and it decides to build parts plants in the U.S., as it heretofore has been unwilling to do. (It now is considering such a move.)

The venture also offers GM two advantages Chrysler and Ford have not mentioned: saving perhaps $2 billion in research and development costs (in replacing the Chevette) and an advantage in meeting stiffer federal mileage and pollution regulations that go into effect at about the time the new GM-Toyota car will begin sales. It will, if successful, help GM compete in selling small cars. Chrysler and Ford have conveniently not noted that they proportionally have a larger share of the small car market and that they are taking advantage of foreign connections to do so. Ford also has more significant operations abroad than is generally realized--making it the number two auto company in the world (considering only domestic operations it is smaller than both Toyota or Nissan).

CONCLUSION

The Toyota-GM venture represents free enterprise--not monopoly. There is no evidence to indicate that the U.S. government or the American public should be concerned that the two companies would or could corner the market. The scope of the joint venture is limited to one factory, to one car, and a fixed time of operation.

Toyota decided on the undertaking for public relations reasons. The milieu was one of bad press in the U.S. toward Japan and specifically toward Toyota--the only large Japanese auto company without a U.S. operation. Senator Donald Riegle (D-MI) recently charged publicly that Japan has "arrogantly cost millions of Americans their jobs" and "has broken up millions of American families." Other congressmen in recent months have made reference to "yellow people" and "Japs" in the context of discussing unemployment in the auto industry. A Chinese student recently was murdered in Detroit by unemployed auto workers who thought he was Japanese. Domestic content legislation in the U.S. threatens Toyota. So do quotas.

Toyota officials have said they hope to sell their part of the venture to GM at a later date. They still fear that linking up with GM and co-producing cars could sully their reputation for quality in the U.S. and throughout the world. Nor is Toyota thinking of cornering the global car market in cooperation with GM. Toyota can do better on its own.

GM was motivated by a need for Japanese technology--not in assembling cars, but in management techniques (especially organi-

zation) and in management-labor relations. The deal may also provide GM cheap access to future Toyota developments in building small, fuel efficient, and clean engines. Japan is ahead of the U.S. industry in this area. And it will provide GM with investment capital to reopen a factory it closed a number of months ago. In auto sales in the U.S. and elsewhere GM will remain competitive with Toyota--as best it can.

The United Auto Workers was motivated by an opportunity to put American workers back to work and to save the auto industry in the U.S. If the Toyota-GM joint venture were to cost more jobs in the U.S. than it would create overall, UAW would hardly support the project. Union leaders also realize that the U.S. auto industry is in dire straits, despite the current recovery. UAW is willing to make concessions; in fact, it realizes it must. And it would prefer to do this in a project where the union is welcome, rather than force itself into a wholly Japanese operation (such as Honda or Nissan).

The transfer of organizational technology from Japan to the U.S. may establish a useful precedent. After World War II Japan obtained valuable technology from the U.S.--making possible its reindustrialization and post-war economic success. Japanese leaders favor providing U.S. companies with new Japanese technology. But they are unsure how they can do this and face opposition from a number of Japanese companies and business leaders. If the transfer works in this joint venture, it will pave the way for much more.

The Toyota-GM joint venture should not be regarded as violating anti-trust guidelines in the U.S. simply because two large companies are cooperating. It should be judged by whether it fosters or stifles competition in the auto market. Since the auto industry has become so international, the Toyota-GM deal must be seen in its global context. GM seems to be getting help in competing in a market where it is not doing well and where, in spite of its size, it is behind many other competitors.

The charges of anti-trust violations seem to stem much more from the fear of competition by Ford and Chrysler than from concerns that monopoly will result. Free competition is threatened by domestic content legislation and by quotas--which seem more likely if this project fails. The Toyota-GM venture will no doubt help avoid both.

History tells us that government legislation which blocks the movement of goods and services and technology has fostered economic depression, the decline of innovation, cultural stagnation, and war. Civilization's advances have taken place in an environment of openness and interchange. This has sometimes been painful. It was for Japan after World War II; but look at the results. It is now painful for the U.S.; but consider the alternatives.

The Toyota-GM venture also carries serious implications for U.S.-Japanese relations. The Japanese government does not want to create more unemployment in the U.S. Yet it cannot abandon its convictions regarding free trade and competition. Similarly, the U.S. government wants to avoid a wave of anti-Japanese feelings in the U.S.--being fueled now by unions and politicians who are looking for votes and seek a scapegoat for the unemployment problem in the U.S. It must be remembered that Japan is America's number one ally, not just in Asia but anywhere. Japan is America's number one overseas trading partner. It is the leading purchaser of American farm products and a number of other categories of U.S. goods. The trade balance in the 1950s and early 1960s favored the U.S. Now, only because of a decline in U.S. productivity, it favors Japan.

Ford and Chrysler have called for congressional hearings to criticize the venture. They have sought to use the press to turn public opinion against the project by portraying the joint venture as a merger. All of this is designed to influence the Federal Trade Commission's vote. The FTC can delay the project (having already done so for several months), issue a complaint, or sue Toyota and GM. Or it can approve the project. The latter decision is in the American interest and in the interest of free trade, American competitiveness, and U.S.-Japanese relations.

John F. Copper
Director
Asian Studies Center