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before the

Committee on
Commerce, Science, and Transportation

United States Senate

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There should be no release of this statement until its delivery, scheduled for 9:00 a.m. (E.D.T.), Friday, December 17, 1982.

Mr. Chairman, the Fair Practices in Automotive Products Act, S. 2300, and its counterpart just passed in the House (H.R. 5133), are designed to reverse deteriorating employment conditions in the U.S. automotive industry. 1/ The Congressional Budget Office's analysis of this proposed legislation concludes, however, that while it would stimulate employment in the auto industry, it would reduce total U.S. employment and output.

CURRENT EMPLOYMENT CONDITIONS IN THE U.S. AUTO INDUSTRY

The U.S. automotive industry is in its worst decline in more than 40 years. This is manifested both in the very depressed levels of automotive production and sales registered thus far in 1982, and in the extremely high rates of unemployment among workers in auto and auto-related industries. Employment in auto manufacturing has fallen dramatically for some four years already—dropping from a peak of more than 762,000 production workers in December 1978 to fewer than 481,000 workers in September 1982. This represents a drop of nearly 40 percent. As of early this month, more than one-quarter million auto workers were on indefinite layoff.

1/ The Congressional Budget Office's estimates of H.R. 5133 are summarized in Appendix A attached to this statement.

A variety of causes underlie the high unemployment among U.S. auto workers. Slow economic growth, recession, and record high interest rates have been the dominant factors holding down levels of domestic auto production in recent years. The displacement of domestic car sales by increased imports, as the U.S. market swung from standard-size toward subcompact models, has also resulted in additional job losses among U.S. auto workers. Over the past decade, foreign manufacturers have nearly doubled their share of the U.S. passenger car market—from 15 percent in 1971 to 27 percent in 1981, and their share has averaged about 28 percent for the first 11 months of 1982. Finally, both productivity improvements and increased "offshore sourcing" of auto components, as domestic manufacturers attempted to respond to heightened foreign competition, have also slowed growth in domestic automotive employment.

Even complete economic recovery from the current recession, in combination with a substantial recovery of past market shares, would not cause U.S. automotive employment to rebound to the peak levels of 1978. Introduction of more efficient plant and processes in the automotive industry, together with the continued shift toward smaller cars, will ultimately mean lower levels of automotive industry employment. Gains in production efficiencies, diminishing labor intensiveness, seem bound to translate into losses in employment. Many of today's auto industry layoffs probably represent permanent job losses.

THE MECHANICS OF S. 2300 AND THEIR EFFECTS ON THE AUTOMOBILE INDUSTRY

The bill now before this committee would attempt to restore U.S. auto industry jobs by instituting minimum "domestic content" requirements for most passenger vehicles and light trucks sold in the United States, beginning with model year 1983. The domestic content requirements--calculated as U.S. value added as a percent of the wholesale price—would have to be met by each domestic and foreign auto manufacturer producing more than 100,000 units for sale in the U.S. market. These requirements would be graduated according to the number of vehicles sold by each manufacturer. After the first year of implementation, increasingly stringent requirements would be imposed until 1985, when the provisions of S. 2300 are to be fully phased in (see Table 1). By that year, the domestic content requirement would be as high as 90 percent for the larger foreign manufacturers.

Industry Effects. If implemented, S. 2300 would impose penalties on producers who failed to meet the domestic content requirements applying to them. Any manufacturer--foreign or domestic—violating the requirements in any model year would have to reduce its total U.S. sales of vehicles and parts by 25 percent in the following model year. Thus, for example, a foreign manufacturer selling 400,000 units in the United States in 1985 but failing to meet its domestic content requirement would be forced to reduce its sales to the U.S. market to 300,000 units in 1986.

TABLE 1. DOMESTIC AUTO CONTENT REQUIREMENTS UNDER THE FAIR PRACTICES IN AUTOMOTIVE PRODUCTS ACT (S. 2300)

Number of Vehicles Sold in the United States	Minimum Percentage U.S. Content Requirement		
	1983	1984	1985
Fewer than 100,000	0	0	0
100,000 to 149,999	8.3	16.7	25.0
150,000 to 199,999	16.7	33.3	50.0
200,000 to 499,999	25.0	50.0	75.0
500,000 or more	30.0	60.0	90.0

SOURCE: S. 2300

The greatest direct effect of this legislation would be on the six large-volume Japanese auto producers and one German firm—Toyota, Nissan, Honda, Toyo Kogyo, Subaru, Mitsubishi, and Volkswagen. If these firms sought to maintain a high sales volume in the U.S. market, they could realistically comply with the provisions of the bill only by relocating a significant proportion of production to the United States; otherwise they would each ultimately be forced to limit sales in the United States to 100,000 units a year. Even if these foreign automakers were to relocate their production facilities to U.S. sites, they would need to meet a 75 percent domestic content requirement overall in order to sell just 200,000 units per year. This is a stringent requirement that would demand not only

the relocation of assembly, stamping, engine, and transmission facilities to the United States, but also the purchase of substantial volumes of domestically produced parts and materials as well.

Because these firms would probably thereby suffer the loss of the cost advantages they now enjoy, no sizable shift of foreign production facilities to the United States would likely occur. Rather, the practical effect of the bill would be the imposition of a rigid import quota of 100,000 units per year on each foreign auto producer. By 1990, the bill would have the effect of reducing auto imports to the United States by as much as two-thirds of the volume that would have been imported otherwise.

CBO ESTIMATES OF THE ECONOMIC EFFECTS OF S. 2300

Like any form of restrictive trade policy, S. 2300 would reduce U.S. national income, and the resultant smaller income would be redistributed in favor of the beneficiaries of the restriction. The bill would undoubtedly stimulate production and employment in U.S. auto and auto-related industries. But these benefits for the automotive industry could occur only at some costs to other sectors of the economy—and to consumers.

Whatever positive economic effects for U.S. output and employment that might result from this bill would probably be temporary. Further, they would depend on the considerable slack now in the U.S. economy. In a more fully employed economy, the overall effects of S. 2300 would likely

be negative: employment and output gains in the U.S. auto industry rely on shifts of capital and labor resources from other parts of the economy. The consequent inefficiencies entailed by these shifts of resources, in combination with the higher inflation likely to result, could dampen real output. The U.S. economy as a whole, therefore, stands to suffer a net loss. This suggests that conventional monetary and fiscal policies might ultimately be safer tools for trying to attain high employment goals.

For the near term, however, the restriction of automotive imports implied in this proposed legislation could have a significant and direct effect on output and employment in the U.S. automotive and related industries. Assuming that domestic sales of new cars do return to earlier trend rates, and that all foreign auto producers increase their sales volumes at rates that maintain 1981 U.S. market shares, S. 2300 would have the effect of reducing auto imports to the United States to about 1.35 million units by 1990--approximately 35 percent of the 3.75 million units that might otherwise have been imported in that year. The displacement of 2.4 million foreign cars would force all new vehicle prices up—by an average of about $500 per unit by 1990. This outcome would stimulate domestic production by, in effect, levying a heavy tax on U.S. auto buyers. In response to higher auto prices, auto sales would be dampened. As a result, U.S.-built vehicles sales would rise by only 1.6 million units, in contrast to the displacement of 2.4 million foreign cars (see Table 2).

TABLE 2. SUMMARY OF CBO ESTIMATES OF ECONOMIC EFFECTS OF DOMESTIC CONTENT LEGISLATION, BY 1990 (S. 2300)

	Under Current Policy	Under S. 2300	Change Resulting from S. 2300
Sales of New Cars and Light Trucks (In thousands)			
Domestic	11,250	12,850	+1,600
Imported	3,750	1,350	-2,400
Total	15,000	14,200	-800
Average Price of Cars and Light Trucks (In 1982 dollars)	8,850	9,350	+500
Employment Effects (In thousands of workers)			
Automobile manufacturing	803	873	+70
Auto-related industries	1,887	2,017	+130
Non-auto-related industries	112,444	112,094	-350
Total	115,134	114,984	-150
Real Gross National Product (In billions of 1972 dollars)	1,923.2	1917.4	-0.3%
Consumer Price Index (1972=100)	486.4	487.9	+0.3%
Unemployment Rate (In percents)	6.5	6.7	+0.2%

SOURCE: Congressional Budget Office.

Corresponding to this increase in domestic auto production, direct employment in auto manufacturing would rise by about 70,000 jobs more than otherwise by 1990; employment in auto-related industries would rise by 130,000 jobs more than otherwise.

Despite these benefits to the U.S. automotive industry, the net effects for the U.S. economy—measured in terms of real economic growth, inflation, and employment—would be negative. The benefits accruing to U.S. automakers would be more than outweighed by the cost borne by the rest of the economy.

There are two principal reasons why such legislation can affect the U.S. economy adversely. First, it can reduce efficiency throughout the U.S. economy by artificially shifting resources from some sectors to others—in the case of S. 2300, to auto production. This has the inflationary effects of driving up the price of labor and capital for all industries, as well as the price of finished goods. Second, the reduction in world trade likely to ensue from the bill would in turn dampen demand for U.S. exports, reducing output and employment in U.S. export industries.

INTERNATIONAL TRADE RESPONSES AND THEIR CONSEQUENCES FOR THE U.S. ECONOMY

The quite possible response of the United State's trading partners to a restrictive policy such as S. 2300 suggests another major area of risk.

Foreign governments whose auto producers were injured by this legislation would have the right, under articles XI and XXIII of the General Agreement on Tariffs and Trade (GATT), to retaliate with dollar-for-dollar trade restrictions on U.S. exports. Foreign economic activity would contract as a result of S. 2300, in turn diminishing foreign demand for all U.S. exports. A reduction in U.S. import demand from fewer auto imports would further strengthen the U.S. dollar on international exchange rate markets, which could raise the price of, and lower the demand for, the export products of U.S. firms. In light of the importance to foreign economies—principally, to Japan's—of their auto industries, and the current depressed condition of the world economy in general, it seems reasonable to assume that these significant international repercussions would be likely. (As passed on December 15, the House version of the bill contains language that would guard against violations of standing trade agreements. The Senate version, however, thus far contains no comparable safeguard.) Any combination of these likely outcomes could harm U.S. economic performance.

Ultimately, the gain of 200,000 jobs in U.S. auto and auto-related industries would be countered by elimination of 350,000 jobs caused by foreign economic responses to the legislation. This asymmetry—indicating that the number of jobs lost through restrictions of U.S. exports would exceed the number of jobs created by reduced auto imports—reflects the fact that U.S. export industries are more labor- and skill-intensive than

U.S. auto and auto-related industries. Assuming that the international economic repercussions that could result in equivalent trade restrictions on U.S. exports did materialize, the CBO analysis concludes that, by 1990, the U.S. price level would be about 0.3 percent higher, real Gross National Product (GNP) about 0.3 percent lower, and the overall U.S. unemployment rate 0.2 percentage points higher than otherwise.

In being a restrictive policy, S. 2300 threatens the unconstrained trading order that has been the keystone of U.S. foreign economic policy. For some 20 years, the United States has pioneered in the dismantling of impediments to the free international flow of goods and services. Adoption of S. 2300 would represent a backward step in this progressive movement. One likely result would be counterproductive trade wars. Under these circumstances, hard-won advantages for the United States and its trading partners derived from a liberal trading order would be lost.

CONCLUSION

The CBO's analysis concludes that, although S. 2300 would somewhat stimulate production and employment in U.S. auto and auto-related industries, it would do so only by imposing sizable costs on the rest of the U.S. economy. Even if foreign economic repercussions were smaller than CBO has assumed, S. 2300 would, at best, provide only a temporary stimulus to overall output and employment. The bill's net long-term

outcome would be negative, any positive effects for the U.S. automotive industry being more than cancelled out by the losses to other sectors of the economy. In the far more likely case of significant international economic responses, the negative effects of S. 2300 on the economy as whole could be markedly greater. The CBO concludes that S. 2300 would not contribute to the objective of higher U.S. employment.

In inviting foreign trade retaliation, the bill runs counter to the longstanding U.S. objective of promoting open and free trade. Accordingly, it risks reigniting trade restrictions worldwide, which, past experience has shown, can have destructive effects not only on the U.S. economy but also on the world economy in general. Trade is no longer a relatively small part of the U.S. economy. Indeed imports and exports each constitute more than 12 percent of our current GNP. Using import restrictions to assist a beleaguered import-competing industry such as autos can boomerang and adversely affect U.S. export industries.

APPENDIX

S. 2300 vs. H.R. 5133

Several important differences distinguish the bill being considered by this Committee from H.R. 5133, the counterpart legislation just passed in the House of Representatives. These differences markedly affect the estimates of both the macroeconomic and microeconomic effects of the proposals. The two most important such factors are the ways in which the two bills define the applicable domestic content requirement, and the way these requirements are estimated.

Differences in Definitions

S. 2300 defines domestic content as the sum of the value of the parts and labor contained in an automobile. The House version of the bill includes in "added domestic value" total U.S. sales plus exports less imports. Included under this broader definition are such added U.S. expenditures as advertising, taxes, customs duties, interest payments, and shipping from docks to sales points. Because of this more broad-based definition, CBO estimates that foreign producers would be able to attain about 25 percent domestic content with only minor changes in production and supply patterns, and without significant relocation of productive capacity. Under the definitions contained in S. 2300, in contrast, attaining domestic content levels in excess of 10 percent would require a major investment for plants in the U.S.

Differences in Content Requirements

Under S. 2300, domestic content requirements are established by fixed percentages, beginning in 1983. For example, for sales of 100,000 units or fewer, no domestic content requirement applies. The sale of just one vehicle beyond that threshold would, however, activate a domestic content requirement of 25 percent for all 100,001 units sold. As sales increase, these requirements increase at set thresholds, with a maximum of 90 percent content required at sales in excess of 500,000 units. By contrast, under the bill just adopted in the House, the domestic content ratio is determined by a formula by dividing the number of vehicles sold between 100,000 and 900,000 by 10,000. So sales of 380,000 would necessitate domestic content of 38 percent.

The Effects of the House Bill

As a consequence of these differences, the House version of the domestic content bill would have only about two-thirds of the effects on the industry and the economy as would S. 2300. The House version would have the effect of reducing imports to the United States to about 2.6 million units by 1990—approximately 70 percent of the 3.8 million units that might otherwise have been imported.

By 1990, the displacement of this 1.2 million units (see Table A) of imports would new force new car prices up by an average of $333 per unit. As a result of this price increase, U.S. demand for autos would decline.

Consumption of U.S.-built cars would therefore increase by 623,000, in contrast to the displacement of 1.2 million units of foreign cars. Corresponding to this increase in U.S. auto production, the CBO estimates that, by 1990, employment in the U.S. auto industry would increase by 38,000 jobs more than otherwise.

The overall effect of the legislation on the U.S. economy would, however, be negative. The benefits accruing to U.S. auto industry would be more than outweighed by the costs to the rest of the economy. A combination of reduced efficiency in the United States, along with lower demand for U.S. exports and foreseen responses from our trading partners, would combine to affect this reduction in overall U.S. employment and activity. CBO results show that, by 1990, the U.S. price level would be about 0.2 percent higer, real Gross National Product about 0.1 percent lower, and the overall unemployment rate about 0.1 percent higher than otherwise. The gain of 107,000 jobs in the auto and auto related industries would be countered by the elimination of 173,000 jobs in other sectors of the U.S. economy due to the above-noted causes.

The CBO concludes that under both versions of the bill, the U.S. auto industry would gain at the cost of the other sectors of the U.S. economy. Becuse of the two principal differences between the bills, both the beneficial and detrimental effects of the House bill would be only about two-thirds the size of S. 2300.

TABLE A. SUMMARY OF ECONOMIC EFFECTS OF DOMESTIC CONTENT LEGISLATION BY 1990 (H.R. 5133 as passed December 15, 1982)

	Under Current Policy	Under H.R. 5133	Change Resulting from H.R. 5133
Sales of New Cars and Light Trucks (In thousands)			
Domestic	11,250	11,873	+623
Imported	3,750	2,603	-1,147
Total	15,000	14,476	-524
Average Price of Cars and Light Trucks (In 1982 dollars)	8,850	9,183	+333
Employment Effects (In thousands of workers)			
Automobile manufacturing	803	841	+38
Auto-related industries	1,887	1,956	+69
Non-auto-related industries	112,444	112,271	-173
Total	115,134	115,068	-66
Real Gross National Product (In billions of 1972 dollars)	1,923.2	1921.3	-0.1%
Consumer Price Index (1972=100)	486.4	487.4	+0.2%
Unemployment Rate (In percents)	6.5	6.6	+0.1

SOURCE: Congressional Budget Office.