

AUTOMOBILE DOMESTIC CONTENT REQUIREMENTS

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ISSUE DEFINITION

In 1981, sales of American-produced automobiles dropped to their lowest level in two decades. As a result, auto industry layoffs have reached record heights both in the Big Four and in supplier firms. Automakers, moreover, increasingly are turning toward international sources of parts and equipment for their cars. This worsens the prospects for employment and profits in supplier industries. At the same time, imports of automobiles continue to capture a large share of the U.S. market.

Japan, moreover, is reported to have a cost advantage over the United States in producing small cars of between \$1,000 and \$1,500--about half of which is attributable to lower labor costs. This has placed U.S. autoworkers in a weak bargaining position in negotiating labor contracts.

In response to these and other conditions, legislation has been introduced that would impose domestic (local) content ratios for automotive vehicles. These would require that cars and trucks sold in the United States in large quantities contain a certain percentage of American parts and labor.

BACKGROUND AND POLICY ANALYSIS

In 1981, sales of automobiles by domestic automobile producers fell to 6.2 million units--the lowest level in 20 years. By March 1982, the number of autoworkers on indefinite layoff again reached 250,000 after declining steadily from that level in August 1980 to 150,000 in June, 1981. Layoffs in auto industry supplier firms also have grown. For each layoff by an automaker, an estimated 2.2 persons are laid off in the firms supplying the auto industry. U.S. automakers, moreover, are turning more toward foreign sources of parts and equipment for domestically assembled automobiles. Detroit views purchasing from foreign sources not only as a method to acquire critically needed parts quickly but as a way to reduce its costs to compete more effectively with Japan. Such foreign purchases also have begun to cut into autoworker employment.

At the same time, imports continue to capture a high percentage of the U.S. auto market. In 1981, despite Japan's voluntary restraints on automobiles exported to the United States, imports accounted for 27% of the U.S. market--up from 18% in 1978 (a banner year for U.S. auto sales). This proportionate increase reflected not so much a rise in absolute numbers of Japanese cars sold as the fact that their sales remained constant while sales of American cars fell off.

Bills have been introduced in the 97th Congress, that would establish domestic content requirements for automobiles and trucks sold in the United States. H.R. 5133 and S. 2300, for example, would require that beginning in model year 1983, all automakers selling vehicles in the United States would have to meet minimum ratios for American value added according to a scale that would depend on the number of vehicles sold. The required U.S. content would be phased in as follows:

<u>Number of Vehicles Sold:</u>	<u>Minimum U.S Content for Model Year:</u>		
	<u>1983</u>	<u>1984</u>	<u>1985 and beyond</u>
Not over 100,000	0%	0%	0%
Over 100,000 but not over 150,000	8.3	16.7	25.0
Over 150,000 but not over 200,000	16.7	33.3	50.0
Over 200,000 but not over 500,000	25.0	50.0	75.0
Over 500,000	30.0	60.0	90.0

The penalty for violating these domestic content ratios would be a 25% reduction in the the number of motor vehicles or parts that the offending automaker could sell in the United States in the model year following the violation. (H.R. 2478 would impose a penalty of \$2,000 per car.)

In effect, local content requirements as proposed in H.R. 5133 and S. 2300 would impose rigid import quotas for both fully assembled vehicles and original equipment and would apply to domestic as well as foreign automakers. No automaker could sell more than about 150,000 units in the U.S. market without local assembly facilities.

The United Auto Workers (UAW) along with the AFL-CIO have been the most vocal supporters of local content legislation. Automotive suppliers also tend to favor the legislation.

According to representatives of the Department of Commerce and the U.S. Trade Representative, the Reagan Administration is opposed to local content requirements on both trade policy and economic grounds. Imported auto dealers vigorously oppose local content legislation, and General Motors and American Motors do not support it.

The debate concerning domestic content requirements centers on their probable effects on U.S. employment and the financial recovery of the U.S. automotive industry. Considerable difference of opinion also exists on several other points, such as whether they would violate U.S. international treaty obligations and whether the proposed phase-in timetable and the level of the content requirements actually could be attained by foreign automakers.

EMPLOYMENT EFFECTS

The UAW has estimated that the local content requirements proposed in H.R. 5133 and S. 2300 would result in the regeneration of 868,000 jobs in the auto and supplier industries--117,000 jobs in the Big Four, 146,000 in U.S. subsidiaries of foreign automakers, and 605,000 in supplier industries.

These estimates are based on the assumption that the market share for imports will rise to 35% by 1985 and that the foreign content of domestically produced automobiles will increase from 3% in 1981 to 10% in 1985, while the U.S. content of imports will remain at zero percent. The UAW projects that a domestic content law would keep imports to 25% of the U.S. market and that those 25% would have 59% U.S. content. It also would keep the foreign content of domestically produced automobiles at only 6% instead of rising to 10% by 1985.

The UAW estimate that 117,000 jobs would be regenerated among the U.S. Big Four automakers by holding their foreign content to 6% instead of 10% appears to be quite high. The Big Four currently employ about 550,000 persons, although they had 760,000 workers in 1978. A reduction of 4 percentage points by 1985 in their foreign content (using an employment figure of 700,000), therefore, would likely "save" about 28,000 direct jobs (4% of 700,000) and about 61,600 jobs (instead of 262,900) in supplier industries. The higher UAW figures appear to be based additionally on the assumption that without domestic content requirements, the market share for imports will rise from 25% to 35%. Major economic forecasts, however, foresee the import market share falling, not rising, over the long term.

For employment gains from substituting U.S.-produced vehicles for imports, the UAW's estimate of 146,000 direct U.S. jobs generated also appears to be quite high. While accurate forecasts of the effect of the local content requirements on imports of automobiles and light trucks are difficult to make, under reasonable assumptions such requirements would likely reduce imports by about 810,000 units by 1985. This assumes that Toyota, Nissan (Datsun), Honda, Volkswagen, Subaru, Mazda, and Mitsubishi all would be required to reduce their imports by 25% per year beginning in 1984 until they reach the 100,000 unit threshold. It also assumes that sales by Isuzu, Mercedes Benz, Volvo, BMW, and Peugeot would grow at the same rates over 1982-85 as they did in 1978-81. It further assumes that British Leyland, Saab, Alfa Romeo, and Fiat will regain their 1978 levels of sales, that Renault (because of its new retailing arrangements with American Motors) will grow 50% faster over 1982-85 than it did in 1978-81, that sales of the Ford Fiesta will remain at 35,000 and sales of the DeLorean will increase to 4,000 units. In this case, passenger car and truck imports would be reduced to 1,954,000 units instead of the 2,764,000 units actually sold in the United States in 1981.

On average, output of 14 automobiles generates one job (man year), and each autoworker job supports 2.2 jobs in supplier industries. A reduction of 810,000 imported vehicles, therefore, would generate approximately 59,000 direct jobs and 127,000 indirect jobs instead of the 146,000 direct and 335,800 indirect jobs estimated by the UAW.

A rough estimate of employment effects of the local content requirements in H.R. 5133 and S. 2300, therefore, would be a maximum of about 87,000 in the automotive industry and 188,600 in supplier industries for a total of 275,600 jobs.

Domestic content requirements at the levels required in H.R. 5133 and S. 2300, therefore, would likely reduce the current autoworker unemployment by about one-fourth. These figures seem to be corroborated by recent experience in the industry. Since 1978, domestic automaker output has fallen by about 3 million units, while indefinite layoffs have increased by 250,000 persons. Domestic content requirements would reduce imports by a maximum of about a fourth the drop in production since 1978. The gain in employment among autoworkers and suppliers, therefore, also should be about a fourth of the current level of indefinite layoffs.

Several factors, however, could intervene to cause the gain in U.S. employment to be even less than that estimated above. The above calculations assume that the 810,000 vehicles purchased instead of the imports are 100% American made. If part of those vehicles are supplied by U.S. subsidiaries of foreign automakers, they will still contain a considerable amount of imported original equipment.

The UAW job estimates, moreover, appear to assume that in the absence of a domestic content law, foreign automakers will not locate in the United States. Actually Volkswagen is increasing its capacity to assemble automobiles and light trucks at its U.S. plant. Honda is scheduled to begin production in 1982 of more than 150,000 automobiles per year at its plant in Ohio. Nissan (Datsun) is building a plant in Tennessee to produce 156,000 light pickup trucks per year beginning in late 1983. Toyota and General Motors as well as Chrysler and Mitsubishi have been discussing joint production of small automobiles. In 1982, Renault, which now owns about half of American Motors, intends to begin production of automobiles at an AMC plant.

A reduction in automotive imports, moreover, could strengthen the value of the dollar on foreign exchange markets, which would lead to fewer U.S. exports and more U.S. imports of other products. Employment for imported auto dealers also would likely be reduced. The net effect on total U.S. employment, therefore, probably would be considerably less than the employment effects for the auto industry alone.

IMPORTS AND RECOVERY

A second point of disagreement concerning domestic content legislation is whether or not the recovery of the U.S. automobile industry depends on reducing imports. Proponents argue that increased imports of automobiles are a primary cause of the high unemployment and low profitability of U.S. automakers. Domestic content requirements would reduce import competition.

Opponents note, however, that in recent years, the number of imported cars sold has been flat. By 1981, the total number of imported cars sold in the United States had increased by less than 500 units from 1979 and had risen by only 325,000 units from 1978. Total U.S. automobile sales, however, had plummeted by 2.8 million units since 1978. Of course, because import sales did not decline as the total U.S. market shrunk, the market share for imports rose. In a relative sense, import demand rose.

In September 1980, the U.S. International Trade Commission determined that imports were not a substantial cause of injury to the domestic auto industry. It viewed the huge drop in total sales, not the small rise in imports, as being a more important cause of the industry's problems. The recession, high interest rates, declining real discretionary income by households, consumer pessimism, high gasoline prices, and other factors have combined to reduce total auto sales.

Imports, however, have placed downward pressure on prices of U.S. automobiles and have set higher standards for fuel economy and certain aspects of quality and performance that Detroit is being forced to match. Imports also have weakened two underpinnings of Detroit's basic marketing strategy, that "bigger is better" and that obsolescence should be built into automobile design.

For autoworkers, imports have drawn attention to their level of wages and benefits which are more than double those in Japan and 50% higher than those in all U.S. manufacturing industries. Even with the wage concessions negotiated in 1982, autoworker wages (including benefits) are expected to rise from \$21 per hour in 1981 to \$24.50 per hour by 1984.

TREATY OBLIGATIONS

A third point of disagreement is whether or not local content requirements would violate U.S. international treaty obligations. Proponents argue that over 30 other countries apply such requirements and they have not been the source of serious trade friction. The United States would merely be providing its industry the protection routinely provided by other countries.

Opponents point out, however, that the proposed local content legislation violates provisions of the General Agreement on Tariffs and Trade (GATT) prohibiting mixing requirements (specifying certain proportions of domestic and foreign components in a product) and import quotas. The Canadian exemption, by which vehicles imported from Canada would be counted as being domestically produced, also could violate the provision for Most-Favored-Nation treatment.

Nations with local content provisions tend to be developing countries that either are attempting to curb the outflow of foreign exchange or are nurturing their own automobile industries. No industrialized countries except Greece, Spain, and Australia maintain local content requirements for automobiles. Auto exporting countries, such as Germany, Japan, France, the United Kingdom, Sweden, and Italy have no such laws. No auto industry that is protected by domestic content requirements is competitive in world markets.

Because the U.S. auto market is the world's largest, a U.S. domestic content law would likely be challenged before GATT or invite retaliation by auto exporting countries. Retaliatory measures would not have to be limited to U.S. exports of automobiles or trucks, but could be applied to products such as airplanes, heavy equipment, or computers. Such challenges, however, usually take considerable time and can provide some breathing room for the U.S. industry.

PHASE-IN TIMETABLE

A fourth point of disagreement centers on the proposed phase-in timetable for the content requirements. Proponents believe that the adverse economic conditions in the U.S. auto and supplier industries have continued so long that firms cannot wait another three or four years for relief. The proposed domestic content legislation, therefore, calls for a partial phase-in of the content requirements beginning in model year 1983 and reaching the ultimate levels by model year 1985.

Opponents argue, however, that no foreign automaker should be expected to plan, construct, and bring production facilities for most of its U.S. sales on line in two or three years. Even Volkswagen and Honda who have U.S. plants in operation or under construction would have to double or triple their U.S. capacity to maintain current sales.

THE REQUIRED CONTENT LEVELS

A fifth point of disagreement is whether or not the required levels are actually attainable. Proponents point to the Volkswagen Rabbits assembled in the United States, which are approaching 75% U.S. content, as evidence that the requirements are reasonable.

Opponents point out, however, that the proposed content requirements are corporate, not model, averages. Foreign car makers sell many different models in the United States. A U.S. assembly plant, however, must produce at least 150 to 200 thousand units to be of sufficient scale to operate efficiently. At best, therefore, foreign producers could efficiently assemble only a few models here. The remainder still would have to be produced abroad. When these imported models are averaged into U.S. production, the corporate average for U.S. content falls dramatically.

In 1981, for example, Volkswagen assembled 162,445 Rabbits in the United States and imported 135,175 Volkswagens, Audis, and Porsches from Germany, the U.S.-produced share being 54%. Assuming that the U.S. produced Rabbits had 70% U.S. content and that the imported vehicles cost the same as the Rabbits, Volkswagen's corporate average U.S. content would have been 38%. Local content ratios of 75 or 90%, therefore, are virtually unattainable without nearly eliminating imports.

Ironically, according to the proposed legislation, a 75% local content requirement for Volkswagen would penalize it relative to a company like Volvo. Volvo could continue to export up to 100,000 units to the United States without any U.S. content. (It sold 65,000 units in 1981. See Table 1.) Volkswagen, by contrast, would be allowed no imports at all, since its U.S.-produced Rabbits would be approaching 75% American content. As long as Volkswagen is not able to exceed 75% U.S. content, it would not be permitted any imports on any sales above 200,000 units no matter how many cars it produced in the United States. Since at that level, 75% U.S. content would be required.

Even if Volkswagen pushed its U.S. content to 90%, at an output level of 200,000 units, it still would be allowed to import only 40,000 vehicles of comparable value. It would have to produce 500,000 vehicles in the United States with 90% domestic content before it would be allowed to import 100,000 similarly priced vehicles from Germany. Before Volkswagen reached U.S. production of 500,000 units, however, its total sales would exceed 500,000 units, and its required domestic content ratio would jump to 90%. As a result its allowable imports would again drop to zero. A foreign automaker with no U.S. manufacturing presence, therefore, appears to enjoy the greatest advantage under the proposed content ratios since it can export 100,000 units with no U.S. content required. Starting production in the United States actually penalizes foreign automakers in terms of their allowable imports into the United States.

The effect of the proposed content legislation, therefore, would probably be to limit imports from any automaker to fewer than 100,000 units. The high levels of U.S. content required in the proposed legislation also could provide an incentive for foreign automakers to locate in Canada and export to the United States under the provisions of the Automotive Products Trade Act of 1965, which allows for duty free entry into the United States of Canadian automotive products (at least 50% Canadian content).

PRICE EFFECTS

Local content requirements, because they are enforced by import restraints, would likely raise prices of both domestic and imported automobiles. Proponents argue that such higher prices are necessary to restore profits and provide the capital necessary for investments by U.S. automakers.

Opponents point out that higher prices hurt consumers and transfer income from buyers to sellers. Such prices also reduce U.S. export competitiveness not only in automobiles, but in industries using automobiles.

LIGHT TRUCKS

Under H.R. 5133 and S. 2300, local content requirements would include pickup trucks as well as automobiles. Proponents argue that imports of pickup trucks from Japan have risen as rapidly as cars. (See TABLE 1.)

Opponents note, however, that the U.S. light-truck industry is already protected by a 25% tariff. (The tariff on passenger cars is only 2.8%.) Many of the light trucks from Japan, moreover, have been sold under U.S. nameplates (Chevy Luv, Ford Courier, Plymouth Arrow, etc.). Not until 1981, did a U.S. automaker begin production of light pickup trucks.

BARGAINING LEVERAGE

Proponents argue that a U.S. domestic content requirement is necessary to give U.S. trade negotiators leverage in bargaining to reduce barriers to U.S. exports in other countries, in particular those with their own domestic content laws. A U.S. content law also could be used to induce Japan to increase its defense spending.

Opponents point out, however, that a U.S. domestic content law would be aimed primarily at Japan. For automobiles, Japan has no local content requirements and has reduced its import tariff to zero. Since the mid-1970s it has been eliminating other barriers to imports of foreign cars, although problems with standards and inspections remain.

JAPAN'S CONTENT REQUIREMENTS ON AIRCRAFT

The UAW argues that domestic content requirements on automobiles are justified in view of Japanese domestic content requirements placed on sales of airplanes from the United States, in particular warplanes and Boeing 767s.

The Japanese government insists, however, that it requires local content only in the purchase of military aircraft for national defense purposes. Japan feels that in case of war, it should have local manufacturers for spare parts.

According to a Boeing spokesman, Japan did not require local content for the Boeing 767 but entered into a risk-sharing agreement. The Japanese companies had to invest in the design and engineering of the parts they make. If the plane sells well, they stand to make profits, but if it does not, they could incur losses.

OTHER ARGUMENTS

Other arguments in favor of local content legislation are that the automobile industry is facing such difficult conditions that any help, no matter what, is necessary. Domestic content requirements also would not cost the Federal Treasury much to implement (compared to various proposals for tax credits or buyer subsidies), and the United States now has opportunity to influence where international automakers locate new plants that if missed might not appear again for a long time.

Other arguments against local content requirements are that they are the type of nontariff barrier to trade that the United States is attempting to reduce in other countries, that they reduce competitive pressures on U.S. companies to cut costs and improve their products, that they would be costly in terms of the efficiency and export competitiveness of the U.S. economy and would require extensive records to be kept on the source of each part entering into the manufacture of a motor vehicle.

TABLE 1. U.S. Passenger Car and Truck Sales by
Auto Manufacturer, 1981
(in units)

Manufacturer	Cars	Trucks
General Motors (Excluding imports)	3,796,696	785,455
Ford (Excluding imports)	1,380,600	652,924
Chrysler (Excluding imports)	729,873	152,719
Toyota	576,491	137,490
Datsun (Nissan)	464,805	115,334
Honda	370,705	----
Volkswagen of America (VW, Porsche, and Audi imports)	306,676 (144,231)	33,879 ----
American Motors-Renault (Renault imports)	167,551 (30,869)	63,275 ----
Toyo Kogyo/Mazda (Incl. Ford courier trucks)	166,105	80,726
Subaru	152,062	----
Mitsubishi (Sold under Chrysler nameplates)	110,940	33,902
Volvo	64,477	----
Mercedes Benz	63,059	4,054
BMW	41,761	----
Fiat (Includes Lancia)	33,253	----
Fiesta (Ford-Germany)	32,856	----
Jaguar-Rover-Triumph	18,956	----
Isuzu (Including Chevrolet LUV trucks)	17,805	71,683
Peugeot	16,937	----
Saab	14,613	----
Alfa Romeo	2,301	----
DeLorean	3,009	----
DOMESTIC TOTAL	6,206,296	1,688,252
IMPORT TOTAL	2,325,235	443,189
INDUSTRY TOTAL	8,531,531	2,131,441

a/ Mitsubshi cars were sold under Chrysler nameplates. The total for Chrysler excludes Mitsibishi imports.

Source: Automotive News, Jan. 11, 1982, p. 45 and Jan. 18, 1982, p. 48.

LEGISLATION

H.R. 2478 (Traxler, et.al.)

Establishes quantitative limitations on imports of autos and imposes local content requirements of 25 percent beginning in 1983 and rising to 75 percent in 1985. Introduced Mar. 11, 1981; referred to the Committees on Ways and Means and Energy and Commerce.

H.R. 5133 (Ottinger, et.al.)

Establishes domestic content requirements for motor vehicles sold in the United States. Introduced Dec. 8, 1981; referred to the Committee on Energy and Commerce.

H.R. 5597 (Gaydos)

Establishes minimum domestic content ratios for all motor vehicle manufacturers which produce over 100,000 vehicles for ultimate retail sale in the U.S. Introduced Feb. 4, 1982; referred to the Committee on Energy and Commerce.

S. 2300 (Ford, et.al.)

Establishes domestic content requirements for motor vehicles sold in the United States. Introduced Mar. 30, 1982; referred to the Committee on Commerce, Science, and Transportation.

REPORTS AND CONGRESSIONAL DOCUMENTS

U.S. Library of Congress. Congressional Research Service.
Automobiles Imported from Japan (by Dick K. Nanto). Issue
Brief No. IB80030. March 12, 1980 (periodically updated).

----- Local Content Laws and Automobile Imports: Arguments Pro
and Con. Report No. 81-191E, by Dick K. Nanto.

----- The U.S. Auto Industry: The Situation in the Eighties (By
Gwenell Bass). Issue Brief No. IB81054. March 30, 1981
(periodically updated).

CHRONOLOGY OF EVENTS

06/10/81 -- House Subcommittee on Commerce, Transportation and
Tourism held markup of H.R. 5133 and forwarded it
to full committee (Energy and Commerce).

06/02/82 -- House Committee on Foreign Affairs held hearing on
U.S.-Japanese Economic Relations including testimony
on local content.

04/14/82 -- 179 cosponsors reported for H.R. 5133, 10 for S. 2300.

03/02/82 -- House Committee on Energy and Commerce held hearing
on H.R. 5133.