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# Misery in Motown

Not since the days of the Edsel has so much gloom descended upon the nation's motor capital—and that was only a $250-million blunder, nothing like this still-unfolding multi-billion dollar slump. Under pressure from affluent Arabs and impoverished Americans, the industry suddenly has found its showrooms deserted; the new-car sales pace so far this quarter has been little better than half the third quarter's 10.3-million annual rate of sales. And with several months' supply of new cars piling up around the country, the industry has taken the unprecedented step of closing down entire plants for indefinite periods, so that as many as 200,000 workers may be on the jobless rolls by Christmas Eve.

For decades, automakers have relied upon the American consumer's steadily rising income to support a strong expansion of their market. Thus, with this year's slowdown in disposable income—and an actual decline in real income—they should have anticipated a weakening of auto sales on the basis of their statisticians' income-sales regression equations. After three very strong years back-to-back during the 1971-73 model years, the inevitable slowdown developed in the 1974 model year—but evidently, that was not the end of the matter. Also, automen historically have relied upon plentiful supplies of cheap fuel to power their products, but here again their longstanding expectations have been dissappointed and the results have shown up on their sales charts.

Even so, industry planners have contributed to their own misfortunes. By concentrating on the production of oversized gas-guzzling vehicles, they apparently have guessed wrong about what the market of the 1970's requires, although in their own defense they can point to the strength of the large-car market in the middle of the past model year. Moreover, by boosting prices sharply and thereby bringing to an end an era of cheap transportation, they have not only pushed many potential '75 sales into the just-concluded model year; but have also priced many customers out of the market completely.

**Prices and income**

The industry's admirable sales record over the decades has been based to a large extent upon its price performance, since new-car prices have consistently lagged behind the growth of disposable income, permitting consumers to buy more (and larger) cars with their increased real income. But now the price of cars has begun to soar along with the price of everything else, helped along by the cost of newly required safety and pollution-control equipment as well as the cost of other materials.

The sharp price increases of recent months have now begun to have an impact. Over the past six months alone, new-car prices have risen at a 20-percent annual rate. (For used cars, prices have doubled at an annual rate.) With a price elasticity of (say) 0.5, the industry could lose about 10 percent of its market with that 20-percent rise. This factor

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would help account for the industry's constantly falling sales forecasts for the '75 model year; originally, the forecast was for 10.5 million units (including imports), but now the standard forecast is closer to 9 million. Besides, much of that market was pushed into last summer's '74 model cleanup, after heavy price increases had already been announced on the '75 models.

The industry's past strength was based not simply on low price but, more than that, on rising disposable income. Thus, the 1973 model year's 16.2-percent rise in consumer auto spending (to a record $44.4 billion) went hand-in-hand with a 12.1-percent rise in disposable income. When income growth sagged to 9.5 percent in the '74 model year—and when inflation brought about a sharp cut in real income—some problems could have been predicted, although nothing comparable to the 12.4-percent sales reduction actually experienced. The extra factor was the soaring cost of necessities. The percentage of food spending out of income, after falling steadily for decades, jumped from 18.1 percent in 1973 to 18.9 percent in 1974. Similarly, the gas-and-oil share of household income rose in the past two years from 3.1 to 3.7 percent. These shifts of course reflect the rapidly rising price of these necessities—11.3 percent for food and 38.5 percent for gas and oil over the past year.

**Ages of cars—and people**

With the growing squeeze on family budgets, consumers may hold on to their present cars longer than usual, thus reducing the normal impact of scrappage on auto sales prospects. The scrappage factor may be diluted also by the relative newness of the auto stock, caused by the phenomenal sales pace of the 1971-73 model period. About 59 percent of all cars on the road were less than six years old in 1973, compared with a 53-percent figure a decade earlier, and scrappage only becomes a major factor after six or seven years.

Another expected prop of the auto market—the sharp rise in the number of young households—may also be weaker than some market analysts have projected. Some rosy sales forecasts had been based upon a one-third increase in the number of households in the 25-34 age bracket during the first half of this decade, but those forecasts had failed to realize that potential demand is not the same as effective demand. In a weakening economy, younger workers are the first to be laid off because of their lack of seniority. Also, with their relatively low wages and heavy needs for family-formation expenses (housing and appliances—and occasionally babies), these young families generally are not new-car buyers, although they provide overall support to the market through their purchases of used cars.

Another important factor affecting most carbuyers, but young buyers in particular, is the state of

the credit market. (Families aged 25-34 account for roughly two-thirds of all consumer debt.) The retail auto market runs on credit, and when credit is expensive or unavailable, the market suffers. This was notably true in the 1974 model year, when auto credit extensions dropped 6.2 percent after two straight years of unparalleled 20-percent increases. More importantly, Detroit by its credit record has shown that it is cutting into future markets, just as it has shown by its sales record that it could cut into its '75 sales by boosting '74s. One manufacturer now writes 17 percent of its sales contracts with maturities of more than 36 months—it had none in this category two years ago—and contracts of as much as 48-months maturity are becoming increasingly common. In this way, many borrowers can be effectively pushed out of the market for years.

**Getting the message**

Standing amidst the shambles of the 1974-75 models, automakers are beginning to get the message that consumers require more economical transportation. Indeed, all of the 22-percent increase in sales since 1965 has occurred in the small-car end of the market (including imports). Despite this indicator, the industry until recently was reluctant to build small cars because they offer a much smaller profit margin than large cars. Besides, with profits today only about one-fourth the level of a year ago, automakers are not anxious to concentrate on low-margin products.

The preferred answer is to pile expensive options onto the small cars. In many cases, this approach has worked quite well. For example, about 50 percent of all small-car owners (domestic models) have been ordering automatic transmissions and about 40 percent air-conditioning. (Optional items can mean as much as a 40-percent profit.) Detroit's past tendency to make small cars larger and heavier over time is no longer a viable solution. Instead, the industry's apparent strategy is to load on the extras, climaxed by the production of a mini-Cadillac.

The long-term result is the development of a different kind of auto market, with small cars accounting for at least two-thirds of total sales in 1980, as against one-half today and only one-fourth in 1968. This type of development in the nation's bellwether industry has important implications, since it could mean significant reductions in manpower and material requirements over time. The industry employs 800,000 workers in its auto and parts plants, and it uses up one-fifth of the nation's steel, two-thirds of its rubber, and one-twelfth of its aluminum and copper. For these and other segments of our auto-based society, some painful adjustments could be required in coming years, although many of the resources freed up here can become available to meet the nation's other needs.

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