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3 Making Sense of the 1981 Automobile VER: Economics, Politics, and the Political Economy of Protection

Douglas R. Nelson

The U.S. automobile industry is highly concentrated (three firms account for the great bulk of automobile manufacturing in the United States), employs a large number of people (over 300,000 in 1978), and has major production facilities in many states (major assembly plants in twelve states and suppliers in virtually every state). The work force is highly organized and represented by a politically active union (the United Auto Workers [UAW]), and each of the majors maintains an individual lobbying presence in Washington as well as a collective presence via the Motor Vehicle Manufacturers' Association (MVMA). When one adds the intangible effect of the strong attachment Americans have to the automobile and the perception of its place in modern American economic development, it is clear that this industry meets virtually everyone's conditions for effective political power. In the late 1970s, faced with slumping sales and profits, rising labor costs, and increased import competition, the industry actively pursued, and ultimately received, protection from Japanese import competition in the form of a voluntary export restraint (VER). At this level of detail, the story seems to be easily rationalized by the simplest form of short-run, profit-seeking political economy (e.g., Chicago school or instrumentalist Marxist). A more detailed study, however, suggests that the reality is considerably more complex.

Simple political-economy models assume that

1. agents (e.g., firms, factor owners, consumers) are rational in the sense that they know how the world works and pursue their self-interests by allocating resources between economic and political activities so as to maximize their wealth;¹

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1. More sophisticated theoretical models emphasize maximization of *welfare*. However, since this is not a particularly operational concept, we follow the general strategy of emphasizing wealth as the goal of economic and political-economic activity.

2. the political-economic environment is simple and transparent, in particular, that
 - a. the economic environment is simple, nonstochastic, and understood by all participants and analysts,
 - b. “Money talks” is a satisfactory general model of the political process, which is generally taken to be nonstochastic,
 - c. political structure, both with respect to particular decisions and the general environment of the decision, is of second-order analytical importance compared with the balance of political pressure.
3. points 1 and 2 imply a simple methodological rule: economic outcomes are informative with respect to the political intentions of agents. Thus, identify the gainers and assert that their political action caused the policy.²

Point 1 seems unproblematic, and probably unavoidable in any systematic study of political or economic action. However, it is hard to make the politics of the auto VER fit easily within the analytical confines of point 2, with the implication that the methodological program following point 2 is seriously undermined. This paper briefly argues that the automobile industry (or at least most of it) successfully pursued a protectionist trade policy agenda, and that the immediate economic return on that agenda was small and known to be small, but that the political (and longer-run economic) return was potentially large, though risky. Furthermore, we will conclude by arguing that the industry failed in this larger political strategy.

3.1 Getting Protection

The exceptionally powerful position of the U.S. automobile industry in the U.S. political-economic structure does not imply that the industry can achieve any conceivable goal, or even that it can achieve a very modest goal with certainty. In addition to the (usually weak) direct resistance from those interests directly harmed by government intervention on behalf of a particular industry, political structure, political norms, and, at least in the case of trade policy, the international commitments of the executive branch all put constraints on particularistic outcomes.³ In addition, the complex relationships between issues and between branches (and subbranches) of government render certainty with respect to significant outcomes virtually impossible. As a result, the political strategies, even of the very powerful, reflect these constraints in both the choice of goals to pursue and in the allocation of resources across venues and over time. Both the power of the auto industry and the constraints imposed by

2. Stigler (1975) suggests that we “look, as precisely and carefully as we can, at who gains and who loses, and how much, when we seek to explain a regulatory policy” so that “the truly intended effects can be deduced from the actual effects.”

3. This is, of course, why particularistic interests generally invest considerable effort in the attempt to dress up the plain fact of greed in the fancy language of national interest.

political and economic structures are well illustrated in the case of the 1981 automobile VER with Japan.

We begin with the institutional constraints. The first step in most protection seeking involves some form of administered protection, the most common form of which is one of the Title 7 mechanisms (i.e., antidumping and countervailing duty procedures). However, politically powerful industries often pursue a strategy in which the administered protection process is only the first step in a more involved political process. In these cases, the administrative mechanism of choice is often the escape clause mechanism and in the auto case Ford and the UAW filed an escape clause suit with the International Trade Commission (ITC) in June 1980.⁴ In addition to whatever direct pressure the industry might bring to bear on the executive, an essential part of the high-track political strategy is mobilization of congressional support. Thus, even before filing the escape clause suit, the industry actively promoted congressional hearings on auto industry trade, which the Subcommittee on Trade of the House Committee on Ways and Means commenced in March 1980. In fact, the ITC, on a three-to-two vote, determined that foreign vehicles were “not being imported into the United States in such increased quantities as to be a substantial cause of serious injury, or the threat thereof, to the domestic industries producing articles like or directly competitive with the imported articles” (USITC 1980).

While surprising to many, the ITC’s negative injury determination was not the end of protection seeking on the political track, rather the emphasis shifted to an even greater focus on the executive via direct lobbying, and indirect pressure through public opinion and Congress. The very visible and public difficulties of the auto industry combined with a growing bilateral trade deficit in U.S.-Japan trade created fertile ground for public claims of unfair trading practices in autos. Trade policy was beginning to emerge as an attractive issue for political entrepreneurs after a hiatus of half a century, and two of the first entrepreneurs to recognize its potential were Senators John Danforth and Lloyd Bentsen, who introduced legislation to quantitatively restrict auto imports in February 1981. Probably the most significant political change in the period following the filing, and ultimate failure, of the escape clause petition was Ronald Reagan’s defeat of Jimmy Carter in the 1980 presidential election. Unlike the Carter administration, the new Reagan administration lacked a strong commitment to trade liberalization as an issue and proved to be considerably more willing to consider trade protection as a policy response to an industry’s

4. This refers to Section 201 of the Trade Act of 1974, which permits the U.S. government, under Article 19 of the General Agreement on Tariffs and Trade (GATT), to provide protection to producers that are “seriously injured” or “threatened with serious injury” by increased imports. If the U.S. International Trade Commission (ITC) determines that such injury has occurred, it recommends an action to the president, who then must decide whether to accept the ITC’s recommendation, take some other action, or do nothing. Finger, Hall, and Nelson (1982) argue that the escape clause mechanism has functioned as part of a political track to protection, while the Title 7 mechanisms constitute a technical track. Nelson (1989) presents a detailed analysis of the political track for the case of the auto industry.

problems than had the Carter administration.⁵ Faced with both domestic (e.g., tax reform) and international (e.g., anticommunism and national security) issues that it considered more pressing, the Reagan administration chose to cede dominance on the trade issue to Congress. Thus the Reagan administration chose to respond to industry and congressional pressure on the auto issue by negotiating a voluntary export restraint with Japan.

Interestingly, the administration's rhetorical commitment to free markets did produce some difficulties in its negotiations with Japan over the VER. Specifically, the administration refused to be seen as publicly demanding such restriction and, in particular, as naming a particular level of restraint. Ultimately, however, following a "nonauto-related" trip to Japan by U.S. Trade Representative Brock in March 1981, the Japanese government announced that it would voluntarily restrict exports of automobiles to the United States to 1.68 million units (a reduction of 7.7 percent on the previous period) for the first year of a three-year agreement, with some unspecified growth in the next two years. In the event, given the continued poor performance of the U.S. industry, the Japanese government retained the limit through all three years.

The story to this point is fully consistent with the simple political-economy model sketched in the introduction: a well-organized, politically powerful industry identified a politically feasible goal, pursued it effectively, and was successful. So far, so good. Unfortunately, when we look at the payoff, the litmus test for the Chicago school model, the account begins to break down.

3.2 The Economic Effects of Automobile Protection

The standard approach to evaluating the welfare effects of the VER involves a straightforward extension of the textbook partial equilibrium analysis of triangles and rectangles. The basic strategy takes observed price and quantity data as equilibrium values and explicit assumptions on functional forms and estimates of elasticities of demand and supply. Under a variety of assumptions on elasticities and cross-elasticities, as well as the initial state of demand, these studies yield estimates of consumer costs from \$1 to nearly \$6 billion, consumer costs per job saved ranging from \$95,000 to \$220,000, and increases in domestic profit and rent transfers to Japanese firms both on the order of \$2 billion.⁶ As a result of the continuing recession, the estimates for the years immediately following the imposition of the VRA are consistently lower than those for later years.

The research that generates such estimates is essentially static in nature; it

5. Trade proves to be an interesting litmus test of an administration's orientation, whether *pro-market* or *pro-business*. Where the Carter administration showed a strong pro-market orientation in trade as well as regulation, at least on trade the Reagan administration was clearly more pro-business.

6. See Case M-22 (Automobiles) in Hufbauer, Berliner, and Elliott (1986) for a convenient survey of the input data that have appeared in the literature.

does not address the more difficult question of the effect of protection on the long-term competitiveness of the U.S. auto industry. One of the problems in carrying out such an analysis is, of course, determining the time horizon over which to make the relevant evaluations. For example, even the static direct effects of protection vary fairly considerably over time, primarily as a function of general macroeconomic conditions. We can, however, informally consider trends in three essential correlates of competitiveness: wages and labor productivity, investment, and quality. With respect to wages, the industry experienced a short term gain in the immediate aftermath of the VER by extracting substantial wage concessions from the UAW. With the protection in place, and the recovery of profits following the improvement in general macroeconomic conditions, the UAW was able to negotiate quite generous wage increases in the 1984 agreements with Ford and General Motors. Given our previous conclusion that the jump in profits primarily reflects increased rent extraction from U.S. consumers, this suggests that the postwar pattern of rent sharing between labor and capital in the auto industry continued more or less unchanged. Thus it would be difficult to conclude that the industry gained much in terms of its relations with labor from either import competition or the subsequent protection.

To a considerable extent the senescent industry argument for protection relies on the protected industry using the period of protection to make fundamental adjustments in the organization of production to improve its competitiveness. It is certainly the case that all three U.S. majors have attempted to make both physical and organizational changes in response to competition from Japanese firms. The industry did undertake considerable new capital spending in the immediate post-VER period and again in the early 1990s and it is likely that these changes have improved its competitiveness, though some of the investment in robots and other new technologies has proven disappointing. The final dimension related to long-run competitiveness is quality, and the perception thereof. At least as important as the industry's product-mix problems were the deterioration in quality and the widespread perception of the U.S. majors as suppliers of high-priced, low-quality automobiles. Here the record is mixed. By the 1990s the perception of quality seems to have improved. However, an analysis of *Consumer Reports* data on frequency of repair suggests considerable improvement in quality by Chrysler in the late 1980s and early 1990s, while Ford and GM show no clear trend. While there has been some deterioration of overall Japanese quality, the most striking fact revealed by this analysis is the continuing gap in quality between U.S. and Japanese producers of automobiles.

Overall, there is no question but that the VER resulted in a substantial increase in industry profits once the U.S. economy recovered from recession and auto demand increased. However, it would also appear to be clear that those profits primarily reflect increased rent extraction from U.S. consumers. Most important, Ford and possibly Chrysler appear to have made substantial adjust-

Table 3.1 Summary Table for Political Economic Analysis

	Time Horizon		
	Short	Medium	Long
UAW	-	+	-
Ford	0	+	0/-
Chrysler	0	+	0/-
GM	0	+	0/-
Japanese	0	+	+
Consumers	0	-	+

ments over the period of the mid- and late-1980s that have increased their competitiveness vis-à-vis their Japanese competitors. It seems reasonable to conclude that the U.S. industry is somewhat smaller, somewhat more flexible, and somewhat more efficient. One must, however, be careful in evaluating the relationship between international competition, protection, and this improved competitiveness. With or without trade protection these firms would have made the adjustments in output mix, production facilities, and organization of production. It is Japanese competition, not U.S. protection, that accounts for the improvements in performance by the major U.S. auto producers. The Chrysler experience is particularly informative when compared to the VER. In the former case, the publicness of the transfer and the emphasis on the responsibility of the Chrysler Corporation and the UAW for the problems of the firm and the solution to those problems created strong incentives to improve performance. With the VER, the implication that the problem was (probably unfair) competition from abroad created poor incentives to improve performance. Where the Chrysler loan was repaid ahead of schedule, the VER, originally intended as a three-year measure, dragged on for nearly a decade.

Table 3.1 provides a very rough summary of this discussion. The participants are entered in the table roughly in order of their degree of support for trade activism with respect to Japanese auto producers (i.e., both support for the VER and domestic content legislation): the UAW and Ford were the most active supporters, with Chrysler holding back during the early period because of the loan guarantee and the Carter administration's opposition to auto protection; GM opposed protection, but not very actively; and the Japanese producers, and the dealers, opposed protection strongly. Although the consumer interest was not well represented (except perhaps by the dealers), they are included in the table to remind us that they are the source of most of the gains realized by the other participants. Because the restraint was not binding in the immediate post-VER period, only the UAW experienced any effect. As a result of the general economic conditions, the UAW made significant concessions during this period. The other agents in the auto industry experienced essentially no gains as a result of the VER. In the medium term, as the economy recovered

and the VER became binding on Japanese firms, all of the active agents gained, while the inactive consumers lost. The evaluation of the long run depends on two factors: how one evaluates the use that was made by the U.S. firms of the period during which the VER was binding, and how one evaluates the effect of increased Japanese investment in the United States. We have argued above that the former effect appears to be small positive to zero, while the latter effect is primarily negative. The entries in the last two cells in the third column primarily reflect the effect of a more competitive domestic market.

3.3 Conclusion: So Why *Did* They Do It?

The U.S. automobile industry sought and received protection from Japanese competition that was not binding in the short run (for reasons that were widely understood at the time) and whose long-run economic effects were, at best, uncertain.⁷ The investment of substantial political resources in seeking fairly modest economic gains at a time when there were a variety of more immediately productive government actions that could be sought (e.g., regulatory relief, direct subsidies, relaxation of antitrust enforcement) strongly suggests that something other than simple rent seeking was going on. Specifically, Nelson (1996) argues that the automobile industry was seeking to reestablish a stable, (imperfectly) competitive regime in the U.S. market by using state power to discipline Japanese competitors. That is, in a reversal of the logic applied in much of the economic theory of regulation which sees economic agents seeking economic goals in the political system, the auto industry was seeking a political goal whose object was the economy.

If we refer to the complex set of arrangements that regulate the relations among the various agents that make up the U.S. auto industry as a “sectoral regime,” the main institutional members of the regime were the three major producers, the UAW, and the various supplier firms. Local, state, and federal governments are all heavily involved with the regime as well. While it would be wrong to see the auto regime as static, or unconflictual, the basic details of the regime were in place not long after the Second World War. The major attributes of this regime were a stable oligopoly, with GM acting as a price leader, and rent sharing between the firms, the UAW, and, to a lesser extent, the supplier firms. The main source of conflict in the regime was primarily over the distribution of the oligopolistic rents. However, as long as the regime remained fairly stable, such conflicts were relatively minor and well institutionalized. For a variety of reasons, the surging Japanese imports in the mid- and late-1970s could not be managed by the industry (as European imports in the late 1950s and early 1960s had been) and threatened the foundations of the regime. In response, the U.S. industry sought protection not primarily for short-run

7. The uncertainty of the long-run effects derived primarily from the effects on investment in the United States by the Japanese majors and questions about the long-run sustainability of protection.

rent-seeking reasons but as part of an attempt to reconstitute the auto regime on more or less the same terms as had existed prior to the import shock.

Ultimately, however, this political effort to recreate a particular economic order failed. One of the striking things about the auto story is that, while the auto industry got more or less what it wanted from the state, it was the U.S. industry, not the Japanese industry, that did the adjusting. Competition in the auto industry is now global competition. Given international sourcing strategies, multinational investment, joint ventures, and captive imports, even the meaning of a “national” industry has become unclear. The U.S. auto industry’s attempt to resist this reality ultimately failed.⁸ That is, the protection may have delayed the adjustment by a matter of five or six years, at considerable cost to the consumer, but the result is a global auto regime. The continued viability of GM, Ford, and Chrysler depends on their ability to adjust to this new reality and to participate in the creation of a political-economic regime that does not rely on the policy actions of a single national government, even one as powerful as the United States.⁹

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8. The attempts by the European industry and by Canadian labor to avoid this logic seem increasingly desperate, though both continue to fight the valiant fight.

9. Note that I am not arguing that government intervention has no effect. Quite to the contrary. We have seen in this paper that the effects can be considerable. The point is that in the context of large changes in a complex industrial regime, it is virtually impossible to predict consequences even if control of such a regime were possible.