Statement of Alice M. Rivlin
Director
Congressional Budget Office

before the
Subcommittee on Trade
of the
Committee on Ways and Means

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There should be no release of this statement until its delivery, scheduled for 9:30 a.m. (E.D.T.), Thursday, September 23, 1982.

Mr. Chairman, the Fair Practices in Automotive Products Act (H.R. 5133) is designed to reverse deteriorating employment conditions in the U.S. automotive industry. The Congressional Budget Office's analysis of the bill concludes, however, that while H.R. 5133 would stimulate employment in the auto industry, this benefit would be more than offset by reductions in U.S. and world employment and output.

CURRENT EMPLOYMENT CONDITIONS IN THE U.S. AUTO INDUSTRY

The U.S. automotive industry is currently experiencing one of its worst slumps in U.S. postwar history. This is manifested both in the very depressed levels of automotive production and sales registered during the first eight months of 1982, and in the extremely high rate of unemployment among workers in auto and auto-related industries. Statistics documenting this decline have been recurring news since late 1978. Employment in auto manufacturing has fallen dramatically since then—from a peak of more than 762,000 production workers in December 1978 to fewer than 482,000 workers in June 1982—a drop of nearly 40 percent in less than four years. As of mid-September 1982, nearly one-quarter million auto workers were on indefinite layoff.

A variety of causes underlie the unemployment among U.S. auto workers. Slow economic growth, recession, and record high interest rates have been the dominant factors suppressing 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. automakers. Finally, both productivity improvements and increased "off-shore sourcing" of auto components, as domestic manufacturers attempted to respond to heightened foreign competition, also slowed domestic auto employment growth.

The increased market share captured by foreign auto producers is the source of heated debate. Over the past decade, foreign auto manufacturers have nearly doubled their share of the U.S. passenger car market—from 15 percent in 1971 to 27 percent in 1981. Since 1981, sales of both imported and domestic cars have fallen off as a result of the recession and high rates of interest. But while the volume of import sales has been dropping, import penetration of the U.S. new car market continued to rise throughout 1981 and thus far in 1982. Last month, imports accounted for a record 32.7 percent of the United States' new car market.

A complete economic recovery from the current recession, in combination with a substantial restoration of past market shares, would still 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 a shift toward smaller cars, will ultimately mean lower levels of automotive industry employment. Many of the layoffs recorded in current statistics represent permanent job losses.

THE MECHANICS OF H.R. 5133 AND THEIR EFFECTS

H.R. 5133 would attempt to restore U.S. auto industry jobs by instituting minimum "domestic content" requirements for passenger vehicles and light trucks sold in the United States beginning with model year 1984. The domestic content requirements—defined as U.S. value added as a percentage of the wholesale price—would have to be met by each foreign or domestic auto manufacturer producing more than 100,000 units for sale in the U.S. market. Once fully phased in, these requirements would be graduated, from 10 to 90 percent, as the volume of vehicles sold by each manufacturer increased.

According to the CBO's estimates, a minimum of 15 percent of the wholesale value of an imported car would qualify as domestic content by 1990, most of this representing expenditures made by foreign manufacturers in the United States for advertising, transportation, raw materials, and accessories. The domestic content of foreign-produced autos could be increased by another 10 percent relatively easily, by foreign automakers' purchasing additional U.S.-built components. Thus, domestic content of around 25 percent as defined in H.R. 5133 would be fairly easy for foreign automakers to achieve by 1990. According to the provisions of the bill, this would mean that each foreign auto producer could export 250,000 units per year without establishing production facilities in the United States on a large scale. To maintain their U.S. market shares, however, the four large-volume Japanese auto producers--Toyota, Nissan, Honda, and Toyo Kogyo (Mazda)--would need to consider relocating a significant proportion of their production to the United States. Honda and Toyo Kogyo could probably meet their required levels without much difficulty, since Honda has already built production facilities in the United States, and since the domestic content required for Toyo Kogyo would be only slightly above the easily acheivable levels. The key uncertainty surrounds the probable response of Toyota and Nissan.

It seems unlikely that Toyota and Nissan would shift sizable amounts of their production facilities to the United States, because these firms would probably suffer the loss of their current cost advantages. Accordingly, the practical effect of the bill for these producers would be the imposition of an import quota. The CBO analysis assumes that, by 1990, Toyota and Nissan would each be forced to limit their exports of autos to the United States to about 250,000 units.

ECONOMIC COSTS OF TRADE RESTRAINTS

Like any form of restrictive trade legislation, H.R. 5133 would reduce U.S. national income and redistribute the smaller amount of income 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 can occur only by making other sectors of the economy and consumers worse off.

Even if Japan—the principal country affected by this bill—did not institute retaliatory restrictive trade actions, the U.S. economy as a whole stands to suffer a net loss. In the current economic environment, however, such legislation might produce some positive results. These would be only temporary, however, not permanent; they would occur only because the economy is now experiencing considerable slack. In a more fully employed economy, the overall effects of H.R. 5133 would be decidedly negative: employment and output gains in the U.S. auto industry would be made possible only by shifts of resources from employment elsewhere in the economy. The consequent inefficiencies entailed by these shifts of resources, in combination with higher inflation, mean that real output would be lower than otherwise. Moreover, import restrictions are not an efficient means of achieving the goal of high employment. This objective is better achieved with fewer risks by conventional monetary and fiscal policies.

In the likely event of Japanese retaliation against U.S. auto import restrictions, the net effects of H.R. 5133 on the economy as a whole would be even worse. Any benefits that would accrue to the U.S. automotive industry would be more than offset by losses imposed on the rest of the economy.

The potential risks inherent in H.R. 5133 go well beyond the apparent negative effects on the U.S. economy. Plainly put, H.R. 5133 constitutes a direct threat to the unfettered trading order that has been the keystone of U.S. foreign economic policy for some 20 years. The United States has pioneered the dismantling of impediments to the free international flow of goods and services. Adoption of H.R. 5133 would represent a backward step—and perhaps a regrettable precedent—in this progressive movement. A 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.

CBO ESTIMATES OF THE ECONOMIC EFFECTS OF H.R. 5133

By restricting imports of passenger vehicles and light trucks, the domestic content requirement legislation would 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 return to earlier trend rates, and that all foreign auto producers (other than Toyota and

Nissan) increase their sales volumes at rates that maintain 1981 U.S. market shares, H.R. 5133 would have the effect of reducing auto imports to the United States to about 2.6 million units by 1990—approximately 70 percent of the 3.75 million units that might otherwise have been imported in that year. By 1990, the displacement of 1.1 million foreign cars would force vehicle prices up—by an average of about $333 per unit—an outcome that would promote additional domestic production by, in effect, levying a heavy tax on U.S. auto buyers. In response to higher auto prices, sales of automobiles would be dampened. As a result, U.S.-built vehicle sales would rise by only 623,000 units, in contrast to the displacement of 1.1 million foreign cars (see Table 1).

Corresponding to this increase in domestic auto production, the CBO's results suggest that direct employment in auto manufacturing would rise by about 38,000 jobs more than otherwise by 1990; employment in auto-related industries would rise by 69,000 jobs more than otherwise.

Despite these benefits to the U.S. automotive industry, the CBO's analysis implies that 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 the U.S. automotive industry would be more than outweighed by the costs borne by the rest of the economy.

TABLE 1. SUMMARY OF ECONOMIC EFFECTS OF DOMESTIC CONTENT LEGISLATION BY 1990 (H.R. 5133 as reported September 16, 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.

The principal reason why legislation such as H.R. 5133 would adversely affect the performance of the U.S. economy overall has to do with the fact that the implied restrictions on auto imports would invite retailiatory trade measures—in this instance, on the part of Japan. Assuming equivalent retaliatory trade restrictions on U.S. exports to Japan, the CBO results show that by 1990 the U.S. price level would be about 0.2 percent higher, real Gross National Product (GNP) about 0.1 percent lower, and the overall unemployment rate 0.1 percentage points higher than otherwise. The gain of 107,000 jobs in auto and auto-related industries would be countered by the elimination of 173,000 jobs caused by retaliatory measures. This asymetric employment response, indicating that the number of jobs lost through restrictions on U.S. exports exceeds the number of jobs created because of reduced auto imports, is consistent with the fact that U.S. export industries are more labor- and skill-intensive than U.S. auto and auto-related industries. In light of the importance to Japan of her auto industry, and the current depressed condition of the world economy in general, it seems reasonable to assume that significant retaliatory steps would be taken. Since this response is sanctioned by articles XI and XXIII of the General Agreement on Tariffs and Trade (GATT), retaliation seems all the more likely.

CONCLUSION

The CBO concludes that, although H.R. 5133 would stimulate production and employment in U.S. auto and auto-related industries, it would do so only by imposing large costs on the rest of the economy. In the unlikely event that Japan refrains from retaliation, H.R. 5133 would, at best, provide only a temporary stimulus to overall output and employment. Its long-term effect would be negative, any positive effects for the U.S. automotive industry being more than nullified by the losses endured by other sectors of the economy. In the far more likely case of Japanese retaliation, the negative effects of H.R. 5133 on the economy as a whole would be markedly worse.

The CBO concludes that H.R. 5133 is a poor tool to achieve the objective of high U.S. employment. It invites foreign trade retaliation, and it 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 disastrous effects on both the U.S. economy and the global economy generally.

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 beleagured import-competing industries like autos can boomerang and adversely affect U.S. export industries.