Testimony
Senate Banking, Housing and Urban Affairs Committee
"Examining the Domestic Automobile Industry"
Submitted by
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My name is Peter Morici, economist and professor at the University of Maryland School of Business. Thank you for inviting me to provide testimony today.

The domestic automobile industry has two major components—the Detroit Three and the Japanese, Asian and European transplants that also assemble and source components in the United States and Canada. Both contribute importantly to the vitality of our national economy. Ensuring these companies have the means to compete globally is vitally important.

The gradual erosion of the market shares of the Detroit Three over the last several decades stems from higher labor costs—having origins in wages, benefits and work rules--poor management decisions, and less than fully supportive government policies. Although the U.S. government has been sympathetic to the needs of the industry, the industry has fallen victim to currency manipulation and other forms of protectionism in Japan, Korea, India, and China.

The Detroit Three are rapidly running out of cash and face filing for Chapter 11 reorganization. It would be better to let them go through that process and reemerge with new labor agreements, reduced debt and strengthened management that would permit these companies to produce cars at costs comparable to those enjoyed by their Japanese and other foreign competitors assembling vehicles in the United States.

Circumstances are dramatically different today than in 1979 when Chrysler received assistance from the federal government. In those days, the challenge at Chrysler was to become competitive with Ford and GM, and Lee Iacocca had a clear plan to achieve that objective and succeeded. Today, the Detroit Three, though improved in productivity and with lower labor costs thanks to concessions from the United Auto Workers, are still not as competitive as the Japanese transplants.

Margins in automobile manufacturing are thin and there is no such thing as being competitive enough. Either a company is competitive or it is not—either it accomplishes the cost structure enjoyed by Toyota and Honda, operating in the United States, or it will continually cede market share and run into financial difficulties.

By assisting the Detroit Three, Congress can delay one or all of them going through Chapter 11 reorganization but sooner or later one or all will face reorganization. The communities and suppliers dependent on these companies would be better off going through that process now than by delaying it with assistance from the federal government.

Without a new labor agreement that brings wages, benefits and work rules in line with those at the most competitive transplant factories, and without reduced debt and other liabilities, the Detroit Three will continue to lag in product innovation and field too few attractive new vehicles, because their higher costs, debt and other liabilities require them to spend less on new productive development than they should. Also, they are inclined to field products with less desirable content to compensate for higher costs. As consumers find vehicles made by Japanese and other transplants more attractive, like those imported from Korea and eventually from China, the Detroit Three will cede market share of one or a few percentage points each year.

If Chapter 11 is put off, the successors to GM, Ford and Chrysler that emerge from a bankruptcy reorganization process will be smaller and support fewer jobs than if these companies endure this difficult transition in 2009.

More jobs can be saved among GM, Ford and Chrysler and their suppliers if bankruptcy reorganization is endured now than in the future.

When Americans buy automobiles from the Detroit Three, more is contributed to the vitality of the U.S. economy than when Americans buy vehicles assembled here by transplants or imports. These vehicles have more U.S. content in terms of jobs, engineering and profits than do foreign nameplate vehicles.

The Congress could take steps to improve the attractiveness of making cars and parts in the United States by improving the public policy environment. This would include finally addressing, directly and forthrightly, undervalued currencies in Asia—currencies kept cheap by intervention by foreign monetary authorities in China and elsewhere. In addition, assertive efforts to develop fuel efficient vehicles could strengthen the industry and create export strength.

For example, Congress could offer an incentive for car buyers to trade in their gas guzzlers—the newer and the bigger the clunker, the more the car buyer would receive under the condition the vehicle is destroyed. This would raise the price carmakers receive from selling smaller vehicles.

Congress could provide substantial product development assistance to U.S.-based automakers and suppliers. The latter includes Toyota, Nissan and Honda, as well as the Detroit Three, battery makers and other suppliers to accelerate the production of innovative, high-mileage cars.

The condition for assistance would be that beneficiaries do their R&D and first large production runs in the United States, and share their patents at reasonable costs with other companies manufacturing in the United States. The huge U.S. market would help attract producers from around the world and rejuvenate the U.S. auto supply chain.