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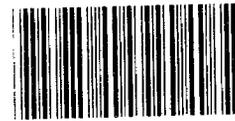
Testimony

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Foreign Direct Investment in the
U.S. Automobile Industry

Statement of
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Before the
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and Trade
House Committee on Foreign Affairs



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Mr. Chairman and Members of the Subcommittee;

I am happy to be here today to discuss with you our work on foreign direct investment in the U.S. auto industry which was undertaken at the request of Representatives Marcy Kaptur, John Dingell, and Edward Madigan. We issued a report on that work in April which addressed a number of questions about foreign direct investment in the U.S. auto industry and highlighted the wide range of potential costs and benefits associated with foreign direct investment in the United States.¹

Concerns over potential negative aspects of foreign direct investment include:

- foreign companies will employ fewer U.S. workers and the jobs that will be available will be at lower rates of pay than would be the case if traditional U.S. companies produced the products;
- foreign companies will import more parts than U.S. companies and tend to buy them from their traditional foreign suppliers;

¹FOREIGN INVESTMENT- Growing Japanese Presence in the U.S. Auto Industry (GAO/NSIAD-88-111).

- foreign companies will benefit from state and local industrial inducement programs, making them more competitive by having access to these state and local subsidies;
- foreign companies will give less weight to the interests of their U.S. workers and the communities in which they locate than to those in their home countries; and
- foreign companies will use U.S. investments as a way of acquiring U.S. technology in order to gain a competitive advantage.

Some of the potential positive aspects of foreign direct investment include:

- foreign capital expands the productive base of the United States beyond what it would be otherwise;
- technology is transferred from the foreign investor to the United States, benefiting the United States;
- jobs that might otherwise be lost to imports are preserved because foreign manufacturers are producing in the United States; and

-- successful foreign investment serves as a stimulus to improve the competitiveness of U.S. firms.

In the course of our work, we could not definitively answer all of these concerns, but we did gain insight into many of them. Since our research focused only on one industry--automobiles--not all of our observations can be generalized. However, because the auto industry is so important to the U. S. economy and represents such a large amount of foreign direct investment in the United States, even observations that cannot be generalized to other industries are important in and of themselves.

IMPACT OF FOREIGN DIRECT INVESTMENT

ON U.S. EMPLOYMENT

The automotive industry has significant employment and pays its workers wages substantially higher than the U.S. average. Therefore, anything that affects employment in the auto industry is considered important. When we tried to estimate the employment effects of Japanese direct investment in the auto industry (the only foreign auto assemblers currently operating in the United States are Japanese), we found that it was impossible to provide a definitive answer. Some factors tend to reduce employment and others tend to increase it. On the one hand, the U.S. assembly plants of the Japanese auto companies--commonly referred to as "transplants"--use fewer workers than traditional U.S.

manufacturers. They also use more imported parts and components, meaning fewer jobs in the parts and supplier industry. On the other hand, the final impact on U.S. employment depends on whether U.S. production of the Japanese automobile companies supplants production of the traditional U.S. companies or displaces imports. Our analysis of the forecasted 1990 U.S. auto market indicates that, if at least 61 percent of the 1.8 million autos estimated to be produced by transplants were either exported or displaced imports, there would be little impact on U.S. employment in the auto industry. However, if transplant production only displaces production of traditional U.S. auto manufacturers, as many as 72,000 jobs could be lost. At the other extreme, if the transplants only replace imports, employment could increase by as much as 112,000.

SOURCING OF PARTS AND COMPONENTS

One concern expressed about the Japanese auto assemblers was that they would buy parts and components only from their traditional Japanese suppliers. We surveyed a sample of U.S. auto parts manufacturers, and discussed this issue with the Japanese assemblers and a number of auto industry analysts. Sourcing decisions appeared to be based primarily on business considerations, such as price, quality, and service. However, we learned that Japanese auto manufacturers have a very different approach to suppliers than the traditional U.S. auto

manufacturers. The Japanese firms use a smaller number of suppliers and tend to retain them for an entire model run; they expect more of their suppliers in terms of design and development of components; they have higher standards for quality; and they are much more directly involved with their suppliers' operations. These differences mean that many U.S. parts suppliers have to make changes if they are to sell to the transplants.

In our interviews, most of the U.S. auto parts suppliers who were selling to the transplants felt that their operations had been improved as a result of these business dealings. They cited increased production efficiency, increased emphasis on quality control, and more constant attention to product and process improvement. Some suppliers said they now felt more competitive and some were now demanding more from their own suppliers.

AVAILABILITY OF STATE AND
LOCAL INDUSTRIAL INDUCEMENTS

There is no question that the Japanese auto manufacturers have benefited from a wide range of industrial inducement subsidies, including property tax abatements, training grants, and development of local infrastructure. Even a state which has a legal prohibition against industrial inducements in the form of property tax abatements was able to make equivalent benefits available by having the auto plant in question built and owned by a local

industrial development authority. However, these programs are not designed for or restricted to foreign companies. U.S. companies have received the largest share of total industrial inducement subsidies. The Japanese auto companies were able to take advantage of these subsidies because they were making site selections for new facilities. From a national perspective, there is little if any justification for such state and local government subsidies to industry; nevertheless, these governments make them available because major new plants mean jobs and greater local economic activity.

PROTECTING THE INTERESTS OF
U.S. WORKERS AND COMMUNITIES

In an era of large multinational companies that buy parts from all over the globe and have production facilities in many countries, it can be argued that production and investment decisions are influenced only by business considerations. The idealized relationships of an earlier era between a company and a community or a company and a specific labor force are gone, if they ever existed at all. However, a concern remains--and has a likely element of validity--when the investment and production decisions of a company are influenced by foreign government ownership, incentives, or laws.

During the course of our work, Volkswagen announced that it would cease production of automobiles in the United States. Volkswagen, as announced, ceased U.S. production at the end of the 1988 model year production run this past summer. Volkswagen was the first foreign auto company to establish an auto assembly plant in the United States, located in New Stanton, Pennsylvania. And, the plant continued operations during the period of the strong dollar in the mid-1980s. In recent years Volkswagen has been losing market share in the United States, and that circumstance provides a basis for the decision to cease operations. However, the Volkswagen experience has raised questions as to whether the decision was a purely business decision or one that was influenced by other than business considerations. For example, Volkswagen is not abandoning the U.S. market, yet it has ceased production despite the substantial strengthening of the German mark and the sharp decline in the dollar since 1985, a change that should have made U.S. production much more cost competitive.

TECHNOLOGY TRANSFER AND THE
COMPETITIVENESS OF U.S. INDUSTRY

When foreign direct investment has involved the purchase of a high-technology U.S. company, it has raised concern about an outflow of technology. This was not an issue in the case of foreign investment in the auto industry. The Japanese auto companies invested in new U.S. manufacturing subsidiaries or joint ventures

which produce Japanese-designed vehicles; if anything, the flow of technology was to the United States, not from it.

With the rise in the market share of the Japanese auto companies in the United States in the 1970s and 1980s, there was considerable debate as to the source of their competitiveness. A long list of possible reasons was developed, including government support, a weak yen, a highly skilled and disciplined labor force, docile single-company unions, advanced assembly technology, special techniques like just-in-time inventory and quality circles, and "Japanese management".

The source of the Japanese auto companies' competitiveness is very important because it has major implications for the U.S. industry. If their competitiveness is primarily the result of government assistance, the U.S. government could be called on to counter that assistance. If the source of their competitiveness was the weak yen, this has been reversed. If their competitiveness is due to a unique labor force, the U.S. companies will not be able to replicate that. And, if the source of their competitiveness is management systems or technology, these can be learned and replicated.

There appears to be some element of truth in most of the possible reasons. The Japanese industry had a developmental period in which it was protected from foreign competition in its home market

by trade barriers. The yen was weak for a long time. The Japanese auto companies do have well-trained and hard-working employees. Some of the Japanese companies did develop highly automated manufacturing plants. And, the Japanese auto companies do manage their operations differently than do the U.S. auto companies. However, it was not until the arrival of the Japanese auto assemblers in the United States that the primary reasons for their competitiveness became clearer.

At the time of our work, three Japanese-affiliated auto companies were in full operation in the United States. Now there are four, with two more in startup. One of the four, New United Motor Manufacturing Incorporated (NUMMI), is a 50/50 joint venture of General Motors and Toyota which produces cars based on the Toyota Corolla. The plant is located in Fremont, California, at the site of a GM assembly facility that was shut down in 1982. An examination of that joint venture is instructive. Absenteeism at that plant prior to its shut down had been very high, productivity and quality were low, and there were thousands of labor grievances. After a couple of years of standing idle the plant was reopened as the joint venture, which put in place the Toyota management and operating systems. NUMMI's labor force is largely made up of former GM workers who had worked at the Fremont plant when GM was operating it. That joint venture is producing cars which, according to GM's own assessments, are the most efficiently produced and highest quality cars in the GM inventory.

Those cars are produced with unionized American workers receiving industry scale wages; many parts and components are purchased from U.S. suppliers; and, the cars' quality is indistinguishable from that of cars produced in Japan. Thus it appears that the competitiveness of the Japanese companies does not rest on any special skills or discipline of the Japanese labor force or any special characteristics of Japanese suppliers. Neither does it rest on some advanced technology, since NUMMI is viewed from the U.S. perspective as a fairly low-technology operation. The primary source of the production efficiency and product quality of NUMMI-- and of the other Japanese auto companies operating in the United States--appears to be the management systems introduced by the Japanese companies.

Perhaps fundamental to the success of the Japanese management systems is the commitment to total quality control, under which a goal of zero defects is established. This approach to quality control was adopted because it was considered and proved to be the least-cost production solution. It underlies all aspects of company operations--design and engineering, assembly operations, human resource management, and relations with suppliers. All employees and suppliers are encouraged and expected to seek ways to improve the product and the economy and efficiency of the production processes.

Parts and component suppliers play an important role in the system. Parts suppliers design components to meet size and performance specifications. Standards for quality, cost, and service are exacting--with suppliers expected to provide perfect parts on a just-in-time basis. It is also the responsibility of the supplier to reduce his cost of production as well as the price charged over the product's life cycle. Improvements in the components are also expected of the supplier.

Just-in-time delivery of parts is important not only because it reduces inventory costs but also because it is central to quality control. In return, a zero-defect standard for components permits smooth operation of the assembly line without large inventories.

Like American companies, every Japanese automobile company has a vertical hierarchical structure. However, the operation of the hierarchy is often different. One key to a successful corporation is the flow of information throughout the organization. The better the information flow, the more efficient the operation will be. In typical hierarchical corporations, officials at every level of the hierarchy appropriate symbols to widen the distance between themselves and the level just below. These symbols are often a bigger office, a closed door, a secretary, an executive washroom, and an executive dining room. This process of building barriers between levels of the hierarchy impedes the flow of information in

the organization. If you go to the Honda plant at Marysville, Ohio, you will see an interesting sight. Everybody wears the same work outfit, from the person sweeping the floors to the President of the company. What passes for white collar work in Honda at Marysville is a large open bull pen with grey metal desks all jumbled together. There are no offices, no doors, and none of the other symbols of hierarchy found in a typical company. And, all of the company officials are there, including the president.

Labor-management relations also differ considerably. In a traditional U.S. auto assembly plant, there are usually over a 100 different job classifications. Labor is used much more efficiently in a Japanese auto assembly plant. The NUMMI plant is an excellent case study. Maximum flexibility on the production line is realized with only four job classifications. Workers function in teams of six to eight responsible for multiple tasks, instead of standing alone on the line and performing individual tasks.

Quality is the responsibility and obligation of each worker in the plant. A clothesline runs the length of the NUMMI production line and, if a worker cannot finish his or her task or if there is a defect in the work he or she pulls the clothesline. The assembly line comes to a stop and the team gathers around to correct the problem. Then the line starts up again. If it turns out that the line is getting pulled too often at any work station, it is taken

as a sign that there is something wrong with the work process at that work station and that work process is redesigned.

Despite some critics' claims that unions contribute to reduced U.S. competitiveness, our work leads us to believe this is not the case. Two of the fully operational Japanese automobile companies in the United States are unionized: NUMMI and Mazda. Two Japanese companies are not: Nissan and Honda. High productivity and quality do not appear to depend on the presence or absence of a union. The case of NUMMI is instructive. Not only is the plant unionized, but almost all of its workers had previously worked for GM at the same plant. However, there are a lot of differences. For example, NUMMI has a contractual commitment to maintain employment to the maximum extent possible. If sales of its cars decline, outside sourcing is to be reduced and work brought in-house in order to provide work for its labor force. There is also a commitment on the part of management at NUMMI to take pay cuts before any workers are let go. When you create a situation in which both management and workers share the benefits as well as the downside of a company's business fortunes, you inevitably end up with workers who are much more forthcoming and committed.

The success of the Japanese assemblers in the United States is having a significant impact on the traditional American auto manufacturers. Their success has been a catalyst for change in the U.S. companies. Furthermore, their joint ventures with U.S.

automobile companies are a vehicle for technology transfer to the United States, not necessarily of some hardware or new material but of the management systems that appear to be the primary reason for the Japanese success. The traditional U.S. auto companies are responding by changing such things as how they manage, the roles of their workers, what they expect from suppliers, and their quality standards. They are responding to the competition and the demonstration effect of the Japanese operations in the United States by becoming more efficient and producing higher quality cars.

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Public interest in and concern over foreign direct investment in the United States is a recent phenomenon. The complex nature of the impact of foreign direct investment is highlighted by our study of the automobile industry. There are many ways in which the United States can and does benefit from foreign investment--and there are some reason for unease. However, our study of the auto industry suggests that it would be a mistake to take action only in response to the concerns about the negatives.

Mr. Chairman, this completes my statement and I will be happy to respond to any questions you may have.