Testimony
House Select Committee on Energy Independence and Global Warming
"Innovation, Jobs and Energy Independence
Reinvigorating the Domestic Automobile Industry"
Submitted by

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My name is Peter Morici, economist and professor of business at the University of Maryland Business School. Thank you for inviting me to provide testimony today.

Automobile manufacturing is a central component of the U.S. economy. Its health and vitality is critical to the prosperity of vast regions of the U.S. economy, and through its purchases, the industry is central to U.S. industrial leadership in activities ranging from microelectronics to metallurgy.

More germane to the work of this Committee, the automobile industry is central to any effort to reduce U.S. reliance on imported oil, curtail global warming, and recover from the recession that now plagues the nation.

The tailpipe offers among the greatest opportunities to both reduce C02 emissions and curtail reliance on imported oil. The domestic industry offers equally significant opportunities for creating vibrant export industries that would support hundreds of thousands of high paying jobs in research labs and high-technology manufacturing and services.

The domestic industry has in the pipeline significant new products that will dramatically reduce energy consumption—advanced fuel-efficient internal combustion engines, hybrids, plug-in hybrids, all electric vehicles, and hydrogen-electric vehicles. As we move down the commercialization curve, learning by producing, costs will come down for the more innovative technologies.

Seemingly exotic forms of propulsion will become commonplace. Americans will have more alternatives to internal combustion engines, and the opportunities to remove oil from the personal transportation equation will multiply.

The country needs viable personal transportation—U.S. patterns of settlement and urbanization make mass transit impractical for most commuters and impractical for even more of non-commuting travel. Plug-in hybrids, and ultimately electric and hydrogen vehicles, offer the opportunity to greatly reduce CO_2 emissions if paired with smart additions to the national power grid.

U.S. leadership in these forms of personal transportation can ultimately create vital export industries—vehicles, components and intellectual property. Failure to lead, ultimately, will require Americans to import what they need and result in a lower standard of living.

The U.S. automobile industry has two components—the Detroit Three and the transplants. Both components are vital to American prosperity but it must be recognized that vehicles made by the Detroit Three have more U.S. content, as measured in technology, components and jobs.

In the global transformation of the basic design of the automobile, the survival and leadership of the Detroit Three will be central to Americans reaping the full benefits of the coming technological transformation in personal transportation. Without them, Americans will miss out on key opportunities in global manufacturing, and be less prosperous in the bargain.

Sadly, the Detroit Three have less capital to develop more fuel-efficient internal combustion systems and alternative vehicles than their competitors. Cash strapped, they have smaller vehicle development budgets than foreign competitors that produce comparable numbers of vehicles. As we have heard in recent weeks, Chrysler and General Motors may be forced to file Chapter 11 reorganization within the next few months. Disruption in the production and payments to suppliers of either of these companies could disrupt the production of the remaining two (including Ford) Detroit Three.

The gradual erosion of market shares of the Detroit Three over the last several decades, and now their hemorrhaging losses stem from higher labor costs—having origins in wages, benefits and work rules--poor management decisions, and less than fully supportive government policies. These conditions have been exacerbated, though not fundamentally caused by, the recent financial crisis and recession.

Although the U.S. government has been sympathetic to the needs of the automobile industry, the industry has fallen victim to currency manipulation and other forms of protectionism in Japan, Korea, India, and China. In addition, the reluctance to raise CAFE standards until recently and less expensive gasoline in the United States have encouraged reliance on less fuel efficient technologies here than in Europe and Japan.

Proposals to save from Chapter 11 one or all of the Detroit Three with a federal bailout would be a poor policy choice if such assistance is not accompanied by specific requirements for systemic reforms that would ensure their long-term profitability and financial capacity to develop more fuel-efficient internal combustion systems and alternative vehicle platforms. Strong profits are essential to their participation in the global transformation in personal transportation technology we are about to witness.

If the Detroit Three, with the cooperation of the UAW, cannot present plans to Congress that would fully and completely align their labor costs and work rule flexibility with Japanese transplants and demonstrate how their vehicle development and distribution costs can similarly aligned, it would be better to let them go through Chapter 11 and reemerge with new labor agreements, dramatically 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, and to devote adequate resources to environmentally essential new technologies. Even with that, these companies would be challenged by the unlevel playing field in competition vis-à-vis Japanese and Korean competitors, who enjoy great advantages owing to currency and trade policies pursued by their governments.

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 an auto company is competitive or it is not competitive—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. That will mean it cannot compete in the development of advanced technologies and adequately contribute to the future prosperity of the nation.

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, without reduced debt and other liabilities and without other management reforms, 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 will require them to spend less on new productive development than they should.

They will continue to be 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, and their smaller profit margins will give them fewer resources for vehicle development and new technologies.

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

If Chapter 11 reorganization is endured now, rather than several years into the future, more jobs can be saved among GM, Ford and Chrysler and their suppliers, and better prospects for U.S. leadership in new technologies can be cultivated.

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.

These kinds of smart industrial policies would contribute to national efforts to reduce CO_2 emissions, reduce oil imports, create high paying jobs and contribute to lasting prosperity.