Domestic Content Legislation: an Overview

GREAT LAKES COMMISSION STAFF

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Great Lakes Commission
2200 Bonisteel Blvd.
Ann Arbor, Michigan 48109
313/665-9135

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PREFACE

Congressman Don Bailey's remarks at the Great Lakes Commission Annual Meeting (October 1982) set the stage for continued GLC consideration of automobile domestic content legislation. The Pennsylvania representative, who is a strong proponent of the legislation, indicated that the legislation could be seen as a vehicle intended to attract public attention to the broader U.S. problems of industrial decline and difficulties in international trade.

This paper was prepared by the Commission staff to provide more background on the issue of domestic content legislation. As an issue with great importance for the Great Lakes reigon, a proposed domestic content require-gement for automobiles sold in the United States has generated a high level of interest. The regional concentration of assembly plants and parts producers along with allied steel and transportation operations points out the concern of individual states regarding the health of these industries.

Proposed content legislation has also produced considerable controversy. The positions of supporters and detractors have been staked out quite forcefully. This background paper attempts to present the issue in an objective manner by detailing the pro and con arguments in respective sections. Much of the information in those sections is couched in advocacy terms reflecting the viewpoints of the particular individuals or groups who are prominent in the debate. This paper does not present an official Great Lakes Commission position on domestic content legislation. The prupose and format of the paper is one of issue analysis and background information and is not intended to make a case in support of or against specific domestic content bills discussed therein.

INTRODUCTION

The traditionally liberal trade policies of the United States are presently challenged by protectionist pressures arising from difficult conditions within the domestic economy. The current global recession has produced relatively high unemployment in most developed countries, increasing the prospect of worldwide protectionist measures. In an attempt to stem the growing tide of protectionism, ministers of the world's major trading nations met in November 1982 for a GATT (General Agreement on Trade and Tariffs) Ministerial Meeting in Geneva. The U.S. delegation included U.S. Trade Representative William Brock and Senator Robert Dole (R-Kansas). In their final communique, the ministers (including the U.S. delegation) agreed to make determined efforts to ensure that trade policies and measures are consistent with GATT principles and rules and to resist protectionist pressures in setting policy and in proposing new legislation. They also agreed to begin groundwork on proposals to limit the temporary trade restrictions a country may legally impose to protect import-plagued industries such as steel, automobiles and textiles.

In the United States, a move toward curbing the influx of automobile imports has been supported and sustained by the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (the UAW). Four years of crisis in the U.S. automobile industry have resulted in nearly one-quarter million unemployed auto workers and perhaps as many as three-quarter million unemployed workers in supply industries. Not since the Great Depression have auto-producing communities experienced such high and consistent unemployment. And despite these difficult conditions, imports of vehicles and parts from Japan have increased, aggravating the domestic automobile industry's plight. This gloomy situation for both employment and production in the auto industry has been the major force behind UAW pressure for enacting domestic content legislation.

A domestic content requirement is a law that requires a certain proportion of the value of a product sold in a country to have been produced domestically. Under the UAW proposal, all automobiles and some kinds of trucks sold in the U.S. market would be required to contain a certain percentage of American parts and labor. Opponents of domestic content legislation argue that it is equivalent to a combination of the more familiar policies of tariff protection for the intermediate goods producer and subsidy to the final goods producer. They perceive domestic content requirements as disguised means to protect the intermediate stages of production, while minimizing domestic and international opposition that the institution of more visible tariffs and subsidies would bring.

The UAW campaign for passage of domestic content legislation has produced considerable debate in Washington. The extent of last year's debate and, in part, support for content legislation is revealed by the fact that the House bill was proposed and endorsed by a large number (224 - December 1982) of co-sponsors in an election year. Conflict arose between Congressmen representing interests of auto workers and auto industry suppliers and members of the Administration concerned over the possibility of violating U.S. obligations under various international trading agreements and the implications of such a law for the international trading system. Supporters of the legislation emphasized immediate, short-term benefits that would accrue to the presently troubled auto industry. Opponents pointed out long-run consequences that would harm export-producing sectors of the economy and eventually undermine the U.S. competitive position in world markets. In a classic case of conflicting political interests, the proposed domestic content requirements forced legislators to weigh the unified interests of the UAW and domestic auto supply industries against the more diverse interests of consumers, foreign car dealers, dockworkers, farmers, and other exporting or import-competing industries that could be adversely affected by such legislation.

The issue came to a head when, on December 15, 1982, the U.S. House of Representatives passed H.R. 5133, the "Fair Practices in Automotive Products Act" (by a vote of 215 to 188). This bill, introduced by Richard L. Ottinger (D-New York), established domestic content requirements for most motor vehicles sold in the United States. The Senate, on the other hand, did not report its version of domestic content legislation (S.2300) from committee. The Senate's reluctance to act on the bill was well-known in advance of the House vote, and thus the House's action has been interpreted as more of a highly visible warning to Japanese officials than part of a concerted effort to enact the legislation during the 97th Congress.

The debate is continuing during the 98th Congress. Domestic content legislation has been reintroduced in the House (H.R. 1234) by Rep. Ottinger and in the Senate (S.707) by Senator Riegle (D-MI). After three days of hearings, the Subcommittee on Commerce, Transportation and Tourism ordered H.R.1234 reported on May 19, 1983. On June 21, the full Energy and Commerce Committee approved the bill on a vote of 25 to 17. The House Ways and Means Committee also has jurisdiction over the bill. This version of domestic content legislation was approved with an amendment. The amendment offered by Rep. Florio (D-NJ) incorporates several provisions of another auto industry protection bill (H.R.3113) introduced by Florio on May 24, 1983. No action has yet been taken on this bill. On the Senate side, S.707, a content companion bill, has not budged from committee and another bill, S.950, introduced by both Michigan senators which provides for mandatory quotas has also not seen any significant action.

It is the purpose of this paper to discuss some of the economic and political implications of a domestic content requirement as perceived by supporters and opponents of the bills, placing them in the context of U.S. national and international policies and goals.

DESCRIPTION OF THE LEGISLATION

The purpose of the "Fair Practices and Procedures in Automotive Products Act of 1983" (H.R. 1234) is to encourage production of automotive products in the United States. Inherent in this purpose is, as the UAW contends, an intent to protect employment in the domestic automobile industry. The Act requires that a certain percentage of each automobile sold in the United States be made in the United States. This percentage, defined as the domestic content ratio, is obtained by dividing the added domestic value (the value of labor and domestic parts) by the aggregate of production costs for all automotive products (motor vehicles and parts used for motor vehicles) sold by the manufacturer in the U.S. The required minimum domestic content ratio for any manufacturer is computed by dividing the number of vehicles sold by the manufacturer in the U.S. by 30,000 in 1984, 15,000 in 1985, and 10,000 in 1986 and beyond. Examples of required minimum domestic content ratios are presented in Table 1.

H.R.1234 requires each vehicle manufacturer that produces more than 100,000 vehicles for sale in the U.S. during any model year, beginning with model year 1985, to "establish and maintain such records, and provide such information, regarding the production and sale of automotive products" as shall be required by the Secretary of Transportation for purposes of carrying out the Act. Moreover, it grants the Secretary of Transportation the power to impose penalties for failing to meet minimum domestic content ratios. The prescribed penalty is a reduction in the vehicle manufacturer's automotive imports (parts and vehicles) into the U.S. market equal to the percentage by which it failed to meet its minimum domestic content requirement. Also, a civil fine of $10,000 for each day of non-compliance is possible.

Table 1: Selected Minimum Domestic Content Ratios (H.R.1234

Number of Motor Vehicles Produced by the Manufacturer and Sold in the U.S. During Such Year	Minimum Domestic Content Ratio in Model Year:		
	1985[a]	1986[b]	1987 and Beyond[c]
less than 100,000	0	0	0
100,000	3.3	6.6	10.
200,000	6.6	13.3	20.
300,000	10.	20.	30.
400,000	13.3	26.6	40.
500,000	16.6	33.3	50.
600,000	20.	40.	60.
700,000	23.3	46.6	70.
800,000	26.6	53.3	80.
900,000 and over	30.	60.	90.

[a] exact minimum determined by dividing the number of vehicles sold by 30,000
[b] exact minimum determined by dividing the number of vehicles sold by 15,000
[c] exact minimum determined by dividing the number of vehicles sold by 10,000

One principal provision of the bill is the creation of a United States Automobile Advisory Council. The Council would consist of the following: four individuals who represent motor vehicle manufacturers, five individuals who represent organized labor in the production of motor vehicles, one individual who represents motor vehicle parts manufacturers and three individuals who represent consumers of such vehicles. These members would be chosen by the President from respective lists prepared and submitted by the Speaker of the

House and the Majority Leader of the Senate. The Advisory Council is charged with the responsibility of formulating a domestic automotive products strategy. The strategy is intended to be the result of continuing studies of the domestic automotive products market and factors affecting domestic production and distribution of such. The legislation expressly prohibits any proposed strategy from recommending deregulation or macroeconomic measures designed to stimulate general economic growth.

In addition to the strategy provision, H.R.1234 also calls for three major studies of the industry and effect of the legislation. Two of the studies are focused on the domestic automotive parts industry and motor vehicle dealerships. The more broad-based impact study will address prices and model availability, parts employment, U.S. investment by foreign motor vehicle manufacturers, and U.S. goods competiveness in overseas markets among others.

The other major House bill pending in Congress is H.R. 3113, "The Domestic Automobile Industry Revitalization Act." Unlike H.R.1234, this bill does not mandate domestic content. However, it does preserve content requirements as an option to be taken if other remedies fail to correct the domestic automobile industry's problems. The legislation is similar to H.R.1234 in that it establishes a U.S. Automobile Industry Advisory Council but places it within the Department of Commerce. The two Councils have similar compositions but under H.R.3113 the three consumer representatives are not present. Under Florio's bill, the Council is charged to formulate a strategy to increase the competitiveness of the domestic auto industry and maintain employment.

The significant difference between the two bills rests with Title II, "Import Relief for the Domestic Auto Industry" of H.R.3113. Under this provision, the International Trade Commission of the Department of Commerce is required to conduct an import injury investigation and make recommendations to the President for remedial action if serious injury (due to import levels) is determined. Such remedial action could include domestic content requirements, import quotas and new tariffs. The Advisory Council could also comment on the ITC's recommendations before they were forwarded to the President. If the President failed to act, Congress could implement some or all of the suggested corrective actions.

Another major difference in Florio's bill is the emphasis on alternative approaches to assisting the domestic auto industry. Studies and task forces would be set up to address such issues as fluctuating and inequitable exchange rates, antitrust law and policies as they affect the U.S. auto industry, and tax policies and import incentives.

SUPPORT FOR DOMESTIC CONTENT

Organized labor, particularly the UAW, has been the principal focus of support. The apparent phalanx of support is not complete; the International Lonshoremen's Association is not backing the legislation because of impacts for the import/export sector. Former UAW President, Douglas Fraser, and other UAW officials have been quite forceful in their advocacy of domestic content requirements. The union's basic argument is that the legislation would preserve or create domestic employment by inducing direct investment in U.S.-based production facilities by foreign vehicle manufacturers, and by limiting the foreign sourcing of auto parts and components by U.S. vehicle producers. Moreover, the UAW argues that these benefits will accrue to the domestic economy with little or no harm done to other sectors of the economy.

Over the last couple of years, import penetration of the U.S. automobile market has been around 25 percent. For this period Japanese cars and trucks have made up around 22 percent of the total market. Nearly one out of five Japan-built vehicles are shipped to the United States. Underlying the UAW position on domestic content is the fear that imports (left unchecked) will capture half the U.S. auto market by 1990. Several sources agree with the UAW's contention. By 1990, import penetration is predicted to be 36 percent by Chase Econometrics, 40 percent by Merrill Lynch Economics, and as much as 65 percent by a National Academy of Engineering panel. A General Motors spokesman recently predicted that import share of the U.S. market could reach 40 percent as soon as 1985--"the year after GM begins receiving small imported cars from Isuzu, the Japanese affiliate it controls."[1] Thus there appears to be some justification for the UAW's alarm.

Moreover, coupled with this alarm is the UAW's belief that "this nation cannot have a healthy economy without a healthy auto industry."[2] In the UAW's view, the automobile industry is the pivotal sector of the economy, in terms of employment, technology, and links to other industries:

> "Even in 1982, the industry employs 700,000 auto workers and 1,650,000 supplier workers, for a total of 2.35 million jobs. The industry consumes 21 percent of all the steel used in this country, 50 percent of the malleable iron, 34 percent of the zinc, 12 percent of the primary aluminum, 13 percent of the copper, 60 percent of the synthetic rubber, and 30 percent of the industrial robots."[3]

From these and other facts, the UAW concludes that the U.S. could not remain a major industrial economy without "a robust and substantial auto industry."[4]

To substantiate their position, proponents of the Act point to studies which estimate that a decline in U.S. automobile production from three-quarters to one-half would eliminate the jobs of more than 200,000 auto workers and approximately a million jobs in the supplier and related support industries.[5] Proponents argue that the U.S. economy cannot withstand such an onslaught and regain its health over the next few years.

The UAW and others argue that domestic content requirements would prevent such a dire deterioration of the U.S. auto industry, and the domestic economy in general. Enacting domestic content requirements would ensure, proponents claim, that the import share of the U.S. automotive market would not rise to it's predicted 40 percent level. Also, the overall domestic value-added of foreign companies would rise to roughly 50 percent of the value of their sales in the U.S. market. Currently, the overall domestic-value added of foreign companies is approximately 15 percent. In addition, foreign sourcing of parts and subassemblies by the largest U.S. companies would be capped at 10 percent of their sales in the domestic market, preventing an estimated rise to 20 percent by 1990.[6]

Supporters of domestic content requirements claim that there is widespread support for the proposition that "companies enjoying large volume sales (in the U.S.) should be investing" in the U.S." The UAW quotes polls showing that the American public suports such a concept by a margin of two to one. Additionally, proponents point out that both Business Week and Automotive News magazines have editorially supported the concept of domestic content legislation for the U.S. automobile industry. And further, Ichiso Shiogi, president of the Japanese Auto Workers, has stated that Japanese auto companies should make significant investments in countries where they enjoy large market shares, like the United States.

Supporters of the "sell here, build here" concept point to two additional facts they believe justifies their position. First, that Volkswagen and Renault have already made substantial commitments in the United States relative to their share of sales. VW began production in the U.S. during 1978. In addition to an assembly plant in Pennsylvania, VW has parts plants in West Virginia and Texas. Domestic content for the VW Rabbits built in the U.S. is roughly 70 percent. Renault also has made a substantial commitment to production in the U.S., providing financing and technology to American Motors Corporation in order to retool the Kenosha, Wisconsin plant for production of the Alliance. Also, other manufacturers such as Nissan and Honda have recently set up U.S.-based auto assembly.

Secondly, the UAW argues, quite correctly, that U.S. auto companies have for decades built in regions where they enjoyed significant sales. Ford is the most obvious example of this preference for direct foreign investment by U.S. automobile producers. Ford's overseas operations are extensive and profitable. Indeed, during the last few crisis years, earnings from Ford's foreign operations were the only thing that kept Ford's overall balance sheet positive. From these facts, supporters of domestic content legislation argue that direct investment in the U.S. can be profitable, and that the strict home-build and export policies of Japan is unusual and unfair, because it fails to produce employment in the U.S. market.

The UAW emphasizes that many other countries, including Australia, Brazil, France, Italy, Mexico, Spain, and the United Kingdom, have some form of domestic content requirement for automotive products, either by law or in practice, both to protect domestic producers and to encourage direct investment in their economies. Also, most other countries, Japan included, protect domestic auto producers by some form of tariff, quota, or non-tariff barrier. As an example, the UAW points to Japan. Effective trade barriers, up to now, have held imported vehicles to a 0.9 percent share of the Japanese market in past years.[8]

From these examples, supporters draw two important conclusions. First, current U.S. trade policies regarding the domestic automobile market are simplistic and outdated in a world where no one else practices "free trade" ideals. Second, the often invoked attack on protective measures like domestic content requirements--that they will result in retaliatory actions by the affected countries--is not realistic. Clearly, the supporters emphasize, the rest of the world has enacted significant protectionist policies successfully without triggering massive bouts of retaliation. Indeed, the UAW reports that most developed countries, which are major export targets for the Japanese automobile manufacturers, have taken actions to limit severely the extent of Japanese penetration in their domestic markets within the past decade; and all without significant response from the Japanese in retaliation. And there has been a developing trend of foreign manufacturers building production plants in other countries, quite possibly motivated, in part, as a means of contending with stiff impact barriers. From these events, supporters of domestic content legislation conclude that the U.S. can similarly enact measures to protect its domestic automobile industry without fear of igniting a worldwide trade war.

In fact, the UAW contends that until the U.S. abandons its outdated and passive approach to trade and industrial policy it will continue to experience recurring trade crises with Japan. Douglas Fraser identifies the problem as "the failure of the two governments to develop a satisfactory <u>modus vivendi</u>" (practical compromise). Critics of current U.S. policy contend that the contrasting difference between the two nations' trade and industrial policies has overwhelmed certain U.S. industries in recent years, fostering enmity and distrust:

> "One of the problems of Japanese trade expansion is that it's been incisively targeted. You [Japan] practically destroy certain industries in the United States -- transistor radios, then the television, and the like. There is a feeling in the United States that the way your trade is targeted corresponds to a whole different set of values. It responds to governmental decisions in Japan, not simply decisions of industry.
>
> This is what is meant by a structural difference between our two systems. MITI decides to make a great effort with computers, so it reorganizes the Japanese computer industry in order to export. Some other industry may be targeted tomorrow. This is what gives apprehension to American industry: maybe they will be singled out next -- not merely by the efforts of one Japanese company, but by a combined, national centrally orchestrated and directed effort, with assistance from the state in the form of reorganization of the industry,[9] assistance in research, and public financial help.

Supporters of domestic content legislation believe that until these fundamental differences are addressed, friction will continue to mount with Japan over trade issues, especially in automobiles. The UAW contends that domestic content measures may be the tool by which the U.S. can fix its deteriorating trade relationship with Japan--before it's too late for modest measures.

The UAW also dismisses two other criticisms of protectionist measures: that they result in unnecessary price increases through reduced competition and restrictions in product choice which are adverse to the interests of domestic consumers. Supporters claim that U.S. producers would continue to be pressured by the discipline of design and engineering innovations of foreign-based manufacturers. The UAW firmly believes that Japanese automobile manufacturers will choose to invest in plants and facilities in the U.S. rather than relinquish their market shares. This infusion of foreign capital and technology will continue to drive the competitive process and keep prices down. Furthermore, this process of direct investment by Japanese producers will ensure that consumer choices are not unnecessarily restricted, because the Japanese producers will continue to offer essentially the same product lines--only domestically produced.

The bedrock which supports the entire pro-domestic content position is the unfailing belief that the U.S. auto industry can "bounce back" to the production levels of more prosperous years. In this view, the greatest threat to the domestic industry is its continued displacement by foreign production. The UAW argues that Japanese production advantages are significantly overstated, and that much of their relative competitive advantage issues from the effects of both their domestic tax system which relates certain taxes for exports, and the unrealistically low price of the Japanese yen vis a vis the U.S. dollar. U.S.-based production by Japanese automobile manufacturers would remedy these circumstances and allow the U.S. industry to recover successfully.

Underscoring this proposal is the firm belief by the UAW and others that industry and labor cannot solve the U.S. automobile crisis alone. They believe government must provide a more stable environment in which U.S. firms can nurture ideas and techniques necessary for their growth and success. Furthermore, government must utilize its monetary and fiscal policies to return the general economy to economic health. Some individuals feel that a content requirement for motor vehicles sold domestically is a valuable tool to be used in more deliberate and reasoned planning of industrial investment and international trade. During 1983, 52 leading economists and academics signed a statement essentially supporting this view with regard to H.R.1234 and S.707. A general recovery will spur auto sales and reemploy thousands of auto workers. Nevertheless, the UAW contends that without domestic content legislation, even general recovery in other sectors of the economy and the fulfillment of the most optimistic automobile sales projections, will not solve the industry's problems. Unemployment in the automobile industry would remain unacceptably high. Not only would imports continue, resulting in an ever-increasing share of the U.S. market, but additionally, "many of the steps in the U.S.-based auto multinationals are taking to improve their competitive position would cause further widespread unemployment and continued erosion of the nation's industrial base."[10] Thus, the UAW is unfliching in its support for domestic content requirements.

ARGUMENTS AGAINST DOMESTIC CONTENT

An issue that has been raised against domestic content legislation but has subsequently been possibly refuted is the matter of compliance with the General Agreement on Tariffs and Trade (GATT). GATT expressly prohibits any regulation requiring proportions of products to be from domestic sources, i.e., domestic content ratios. Domestic content requirements would appear to be directly contrary to the requirements of Articles III and XI of GATT, which provide for national treatment under domestic laws and prohibit quantitative restrictions. However, Article XIX of GATT titled, "Emergency Action on Imports of Particular Products" does allow for the suspension of obligations under GATT in the event that imports of a given product cause or threaten serious injury to domestic producers of the same or competitive products. This provision is referred to as the "sectoral safeguard" measure. Thus, the

American Law Division of the Congressional Research Service has interpreted the Article as allowing such a remedy as domestic content requirements, provided the required findings on injury are made. This view was articulated with reference to H.R.3113, but according to supporters of H.R.1234, it would also prevail with regard to that legislation. Furthermore, content legislation supporters believe that it is unlikely that Japan or any other country would bring a complaint under GATT against the United States for fear that the U.S. would employ the same mechanism against them.

Views in opposition to the proposed domestic content legislation are widespread and held as strongly as those in favor of the legislation. Media support for content legislation has been negligible; even in the industrial heartland editorial opinion has been largely negative. The Detroit Free Press, Detroit News, Chicago Tribune, Chicago Sun Times, Indianapolis Star, Pittsburgh Press, to name a few, all have aligned themselves in opposition to the idea of domestic content, and protectionism in general. On a more national scale, the Wall Street Journal, New York Times, Washington Post, and the Journal of Commerce have voiced solid their opposition to domestic content requirements.

Firm Congressional support for domestic content requirements and protectionist measures in general has wavered lately. The high level of political support evidenced during the 97th Congress has lessened, indicating it was possibly based on "politicizing" considerations in an election year and not on the merits of domestic content. In the last Congress, the House version of the bill claimed 224 supporters, including House Speaker Tip O'Neil. This session's version (H.R. 1234) has 155 co-sponsors. H.R. 3113 has only one co-sponsor, its author, Rep. Florio. Moreover, during last year's House approval, supporters of the bill were unable to defeat an amendment attached by Millicent Fenwick (R-New Jersey) stipulating that the measure should not "supercede the terms or conditions of any treaty, international connection or agreement on tariffs and trade." This provision, it was thought, would have enabled U.S. courts to invalidate the measure for violating the GATT. Political support in the Senate was insufficient even to bring the bill (S.2300) out of committee and before the full membership. Even if it had reached a vote, it would have failed; over sixty Senators strongly opposed the measure. In addition, the Congressional Budget Office (CBO) and the Federal Trade Commission (FTC) have come out against the bill..

Irrespective of Congressional attitudes toward the bill, the Administration's position is very clear. President Reagan stated numerous times that he would unhesitatingly veto any such measure to reach his desk for signature. On March 4, 1983 the President reiterated his objections by saying the bill was the product of a "bunker mentality" and would both increase substantially the cost of a new car while destroying more jobs than it would save. Members of his Cabinet and other Administration officials were also direct and outspoken in their criticisms of domestic content requirements, and protectionism in general. Leading the Administration's attack were U.S. Trade Representative William Brock, Secretary of Commerce Malcolm Baldridge, Secretary of Labor Raymond Donovan, and Secretary of Treasury Donald Regan and the Departments of State, Defense and Agriculture.

Support from industry and other labor organizations was lukewarm or worse. Even the "Big Three," GM, Ford and Chrysler, testified against the measure (H.R.1234) in Congress. However, Chrysler has publicly spoken favorably of the basic approach embodied in H.R.3113. Labor employed outside the auto industry also testified against the measure in various Congressional hearings.

Opposition to the domestic content legislation (and trade protectionism in general) has focused on three basic elements. First, that the automobile industry itself--both labor and management--was largely responsible for its own problems, not the Japanese. The general belief is that the Japanese had exacerbated the situation (and were being dealt with by the negotiated quotas), but that long-standing structural problems and a general economic recession are the underlying cause of the industry's difficulties. Therefore, domestic content is either unnecessary or, worse, would retard necessary structure changes now underway. Second, opposition emphasized that the jobs creation and preservation effects of the legislation were overstated. Third, those opposed to domestic content legislation emphasized the damage such an action would have on our world trading position.

Even though the import percentage level has been rising and is around a quarter of the domestic market, many supporters of domestic content requirements attribute the depressed state of the automobile industry to the rising inflow of imports. Opponents note that in absolute unit terms automobile imports have actually fallen. In 1982, they were less than in the same period in 1980 and 1981. Import sales have also declined an approximate 11 percent during the same period. The apparent growth in Japanese penetration (75% of 1982 import car market--up from 67% in 1978) can be attributed to the simple fact that during the economic recession, sales of less expensive (on averag Japanese models did not drop as fast or as far as sales of more expensive. priced U.S. models.

Imports have aggravated the current situation, but they have not been the sole cause of injury, a U.S. International Trade Commission (ITC) report concluded in 1980. The ITC report identified the tremendous drop in total vehicle sales, and not the rise in imports, as being the major reason for the industry's current problems. Losses in relative market share and decling absolute sales for the U.S. auto companies reflect problems of a transitional period in the domestic market, magnified by the current recession. Past petroleum shortages and subsequent price increases have had a tremendous impact on the automotive industry, because automobiles are the single largest users of petroleum in the U.S., accounting for approximately 40 percent of total consumption. The sudden shift in demand for energy efficient automobiles that followed the oil crisis of 1973 caught U.S. manufacturers unprepared. The result was excess demand for small fuel efficient cars and insufficient U.S. supply.

Although the auto industry is now well into the transition to production of energy efficient automobiles, it has incurred large investment costs that have contributed to corporate losses. In addition, the recession caused by years of inflation and high interest rates has had a disproportionately negative effect on demand for durable goods like automobiles. Moreover, the structural shift in U.S. automobile production and marketing appears to be permanent. Proponents of a domestic content law argue that impact restrictions of some kind are necessary to give the industry a "breathing spell" which to recover. The ITC report, however, states that "the plans underw for restructuring the industry address many of the industry's problems and do not depend in any demonstrable fashion on import relief." Further support for this position is provided by the CBO, which estimates that import pénetration will level off below 30 percent once the economic recovery takes hold, never reaching the dire levels predicted by other sources.

Moreover, a chief concern of opponents is that to the extent that a domestic content requirement would reduce import competition, it would also reduce the incentive for rapid and efficient quality improvements in domestically produced automobiles. The presence of imports has moderated the price of U.S. automobiles and set higher standards for fuel economy, quality, and performance. Elimination of import competition could discourage the major auto companies from completing their conversion, placing the burden of higher auto prices on consumers. By limiting domestic producers' access to cheaper foreign components and equipment, domestic content legislation would impose significant constraints on their ability to minimize production costs. Furthermore, reduced competition would encourage oligopolistic pricing practices in the U.S. market by U.S. auto producers and by foreign producers attempting to recover the cost of building new plants in the U.S. to comply with the Act's requirements. Congressional testimony of the American Automobile Dealers Association described any measure that would create such conditions as "a step in the wrong direction as far as solving the domestic auto industry's principal problem--its inability to produce cars of equal quality to imports at equal cost."

Opponents of domestic content requirements argue that it has become evident that internationalization of automobile production is a trend of the future. In order to survive in the increasingly integrated world economy, U.S. firms must participate in international competition. This concept was well summarized by Marina Whitman, Chief Economist for General Motors:

> "An open trading environment also serves the long-term interests of major U.S. producers--including auto producers--which need open trade to rationaize their production on a global basis. U.S.-based multinational firms would be adversely affected both by domestic trade business that hinder the flow of parts and components in a global industry, and by foreign retaliation that would restrict access to markets abroad."

Imposing domestic content requirements on U.S. manufacturers would insulate the U.S. auto industry and would rule out any possibility that domestic companies could become competitive in world markets (by restricting their access to cheaper foreign-made parts and components) where much of future automobile sales growth is expected to occur.

Inflationary effect on automobile prices would be a direct cost to the American consumer. Some proponents of content requirements maintain that the higher prices are necessary to restore profits and provide the necessary capital for investments by U.S. automakers, the "breathing spell" argument reviewed above. This argument still places the burden on consumers. Higher prices would serve as a conduit transferring income from buyers to sellers; U.S. consumers would be asked to subsidize automobile producers. The Congressional Budget Office estimates that domestic content legislation would increase domestic automobile prices by at least 10 percent. A recent study by the Wharton Econometrics Forecasting Association estimates average new car prices would increase $800 by 1987.

In addition, it is probable that consumers would bear further burdens. It is questionable whether foreign automobile producers, faced with domestic content requirements, would be willing to replicate their entire model-line domestically as the bill's supporters maintain. The Japanese place great emphasis on the cost efficiencies available to them as a result of their highly integrated and flexible manufacturing systems and that such systems cannot readily be moved offshore. The large Japanese producers have indicated that high domestic content requirements would actually reduce their overseas investments, because such requirements would interfere unacceptably with the efficiencies of their production methods. While these claims may be only political posturing, it is significant to note that Nissan has curtailed negotiations with the United Kingdom over building an assembly operation there after that country set an 80 percent domestic content requirement. Furthermore, even if Japanese firms did begin U.S.-based production as the UAW and others claim they would, it is unlikely that they would offer as complete a selection of models. Certain model lines now built in Japan and exported to a number of countries would not have enough sales solely in the U.S. to justify separate U.S. production facilities. Thus, consumers would have their range of model choices restricted. Together these conditions would mean even more restricted competition (and thus still higher U.S. auto prices) and restricted consumer choice and thus reduced consumer welfare. Clearly then, opponents claim, the increase in welfare of one sector of the economy (auto workers) would be at the expense of another (consumers).

While these considerations are strong arguments for opponents of the legislation, their major arguments against domestic content requirements concern its employment effects. The major reason for implementing domestic content legislation is the creation of additional jobs and the preservation of existing ones. Opponents claim that net growth in employment due to increased domestic content in U.S. autos is likely to be negligible or worse. The UAW estimates that H.R. 1234 would preserve or create about one million jobs, a tremendous amount compared to the CBO's estimate of 100,000. The Wharton study estimated that H.R.1234 would save or add 22,000 U.S. auto jobs by 1986 and 58,000 by 1991, but directly related job losses would amount to 53,000 and total export-related employment could fall by 365,000 by 1991. The divergence of these estimates is due primarily to a difference of opinion on two important assumptions.

The first concerns the impact of H.R. 1234 on auto prices. The UAW assumes that automobile prices will not rise as a result of content legislation and thus that total new car sales would be substantially unaffected by content requirements. The CBO, conversely, estimates that sales of new cars would be "very hard hit by the price increases" content requirements would engender. This price-induced contraction of demand for new autos would mean fewer jobs created and fewer preserved. Moreover, opponents argue, higher car prices will ultimately lead to a general economic slow-down. U.S. consumers, saddled with higher car prices, will not only buy fewer automobiles but also--because higher auto prices will reduce their incomes--buy fewer of all goods. This will lead to layoffs in almost all U.S. industries as consumers trim their spending. Opponents claim that both effects of content legislation, the direct upward pressure on domestic automobile prices and the middirect dampening of consumer expenditures, will mitigate the bill's projected employment benefits.

The second difference of assumptions concerns the matter of foreign retaliation and other trade effects. The UAW believes that there will be few, if any, negative effects; opponents argue that retaliation and other effects will be severe, contracting domestic employment in the exporting sectors of the U.S. economy. The net effect, says John F. Cogan of the U.S. Department of Labor, is that a domestic content law would not create jobs, but "swap jobs" in some industries for jobs in other industries.

One uncontested and immediate effect of content requirements would be to increase unemployment among dock workers and others involved in the distribution network for imported automobiles. Also, the decline in automobile imports caused by this legislation would reduce the number of U.S. dollars that Americans offer in return for imported autos. As the supply of U.S. dollars in foreign exchange markets fell, the dollar would appreciate vis a vis other currencies. This would exacerbate the present problems associated with an over-valued U.S. dollar. Because of a higher price for the dollar relative to foreign currencies translates into higher prices for U.S. exports, demand for U.S.-produced goods would decline, leading to a further deterioration in the U.S. balance of trade.

An appreciating dollar would also harm U.S. import-competing industries. While foreigners would find U.S. exports becoming more expensive, Americans would find foreign imports becoming relatively cheaper. The reduced domestic demand for import-competing products (e.g., steel, textiles, clothing, and shoes) would lead directly to additional layoffs in these already depressed industries. The extent of the impact on the U.S. balance of trade and services would depend on the size of the exchange rate adjustment that occurred in response to fewer imports. The greater the effect of a content requirement on foreign imports the larger the "job swap."

A more alarming prospect for many opponents of domestic content requirements, however, is the possibility that content law enactment will precipitate substantial foreign repercusssions--retaliation potentially leading to a general trade war and breakdown of the international trading system. The UAW argues that Japan cannot and will not retaliate. On this point, the UAW contends:

> "As a practical matter, Japan has a very limited capacity to take action against the U.S... Japan buys from the U.S. only what it cannot make for itself: raw materials and products using technology it does not yet have."

Coupled with the assertion that there are no practical alternative sources of supply for these goods and services, the UAW concludes that Japan cannot retaliate. On the second point, the UAW emphasizes that the Japanese have not retaliated yet against other countries taking similar actions.

But opponents feel the UAW's position on this matter is both simplistic and short-sighted. They emphasize that restrictions applied to the U.S. market are far different in significance for the Japanese than actions taken by other smaller nations against them. In 1982, the value of U.S. imports of Japanese automobiles was 13 billion dollars. Because of the value and significance of this trade, and the effect its curtailment would have on the Japanese economy, opponents argue that Japan would retaliate against U.S. exports. Japanese public opinion would be incensed by the perception that the Japanese automobile industry was unfairly being made a scapegoat for the self-inflicted problems of the U.S. auto industry. The recent decision by the Japanese government to free up restrictive import rules on a variety of products such as cigarettes, high tech goods and some foodstuffs would probably not have happened in a domestic environment reeling from the effects of content legislation.

American policymakers need to be wary of the symbolic significance of content legislation as it may be perceived by other trading partners. The passage of such protectionist legislation could signal to other countries that a new order is about to prevail. Other countries may initiate pre-emptive protectionist moves intended to insulate their domestic economies from imagined or real threats--all couched in nationalist sentiment. The results of such a situation could spiral out of control. The consequences for other sectors of the U.S. economy and the world trading system would be serious.

The U.S. economy has a large stake in foreign trade. Within the manufacturing sector exports account for 13.7 percent of all jobs. If exports were to decline, workers in America's leading export industries such as computers, aircraft and semiconductors could lose jobs. The agricultural sector is also sensitive to trade restrictions that may hamper export opportunities. Exports account for roughly one-fourth of U.S. farmers' total revenue. U.S. farmers already find their competitiveness in world markets undermined by the European Community's use of export subsidies for their agricultural products. U.S. farmers feel that in implementing a protectionist policy such as H.R. 1234, the U.S. would weaken their efforts to remove the unfair trade barriers imposed by their European partners. Indeed, this was a major concern of U.S. Trade Representative William Brock prior to the GATT Ministerial Meeting held in November. The possibility of foreign retaliation was also feared. In fact, Ambassador Brock believes that the U.S. trading partners' retaliatory response to "the illegal U.S. trade actions mandated by H.R. 5133 (1982 version) would be imminent."

One issue that remains unresolved but carries with it substantial potential problems is the effect of domestic content legislation on the U.S. Canada Automotive Agreement of 1965. The agreement provides for duty-free trade in automotive products. A major stipulation was a minimum North American content requirement of 50% (1968 and beyond). Also, in order to allow for continued growth of the Canadian vehicle assembly industry a minimum 75% production to sales ratio was agreed to. This provision is a quasi-content measure but relates only to assembly. It would appear that any domestic content requirement would not contravene the express provisions of the bill but that the spirit of the accord would be frontally challenged. U.S.-Canadian international relations could suffer immeasurably. A satisfactory resolution could be arranged through an exemption or bilateral quid pro quo agreement or some other effort if domestic content requirements become law.

OBSERVATIONS

The erosion of support for domestic content legislation does not necessarily forecast its demise. The U.S. automobile industry is caught in the initial throes of general economic recovery but remains battered from events of the recent past. Even though U.S. auto sales have improved considerably, raising hopes that a long-term production upturn is underway, there is still uncertainty as to the outcome. Manufacturers have not been able to wean consumers from rebates and subsidized financing. Sticker shock remains as well as do relatively high bank interest rates for auto loans. This not wholly optimistic situation for auto sales, coupled with continued high unemployment in auto, steel and auto parts production have combined to keep the light on the domestic content bills.

Certain recent events and proposals suggest there may be alternatives to content legislation that would not be as drastic or, perhaps, controversial. H.R.3113, because it does not require content requirements but preserves the option of implementation, is a major innovation and a decided compromise piece of legislation. Also, the studies required by the bill will shed light on the extent of the import penetration problem and should suggest alternative remedies in addition to possible content requirements.

The recent extension of the Japanese auto import restraint agreement for a third year is one example. This agreement results in an annual ceiling on auto imports from Japan pegged at 1.68 million units. The voluntary quota will expire on April 1, 1984 unless a renewal can be negotiated. Japan has wavered on the possibility of another extension at the existing ceiling number. Detractors of the voluntary quota plan believe that the 1.68 million unit level did not result in much hardship to the Japanese during the sales downturn period and therefore was not an indicator of a prospective policy. Also, opponents of this approach belive that U.S. car prices have been driven up as a result of foreign car import restrictions. A realistic voluntary quota arranged through bilateral negotiations remains a serious future option. This approach can be likened to the extension of the gloved hand before the raising of the mailed fist.

The unilateral import quota is another possibility. On March 24, 1983, the two Michigan senators introduced S.950, a Japanese auto import quota bill. This legislation would limit the number of cars to 1.28 million in 1984 and 1985 and 14% of the total number of new cars sold in the U.S. in 1986 and 1987. This bill could pose legal difficulties for compliance with GATT. A positive point is the legislation's temporary time-frame. The authors believe that the resulting "breathing spell" for domestic manufacturers would be sufficient to help the industry weather its transitional rebuilding period.

Another alternative approach to content legislaton, although not part of the legislative arena, is a government policy that encourages foreign vehicle producers to build and/or operate assembly and parts plants in the U.S. Honda, Nissan, Renault, Mercedes Benz, Volkswagen, and possibly Toyota in the future have all taken this tack. Single company assembly plants and only a few parts suppliers are the extent of the commitment to-date from the above manufacturers. Volkswagen's decision to locate an assembly plant in Pennsylvania and consider another site in Michigan (recently sold to Chrysler) was spurred initially by high German production costs. However, the decisions by the Japanese to follow suit were supposedly motivated more by political considerations than financial reasons. Toyota, the latest entrant in the U.S. basing scheme, awaits a favorable ruling by the Federal Trade Commission before it can go ahead with its joint GM venture to reactivate an idle California assembly plant. This GM-Toyota plan, along with the alliance of American Motors and Renault, illustrate a changing complexion of the previous go-it-alone approach to U.S.-based manufacturing.

The fledgling but expanding commitment by foreign auto manufacturers to build in the U.S. is a positive factor in retaining U.S. jobs in automobile production. Aside from union representation concerns and the continued need for increased parts and sub-assembly components production in the U.S., the American public should be encouraged by the trend.

Favorable governmental policy consideration can take many forms and may emanate from all levels of government. Some examples include: tax incentives, write down of land costs, vocational training, guaranteed loans, transportation and utility improvements and as alluded to already, propitious rulings regarding economic regulatory action. Other kinds of changes in pollution and safety regulations could assist the industry but need careful balancing with the perceived public good. Such public sector "assistance" to the U.S. automobile industry is not uncommon. There are numerous avenues of cooperation that can be pursued as an alternative to domestic content legislation.

One contemporary example of federal action regarding a vehicle manufacturer in its battle with imports deserves more detailed mention. President Reagan recently imposed a stiff new tariff schedule on imorted large motorcycles, an effort to give Harley-Davidson Motor Co. (the only remaining U.S. motorcycle company) protection from Japanese competition. The temporary duties are coupled with a provision exempting several thousand cycles by individual producing countries. The Administration believes the tariff action will encourage the Japanese to aid the U.S. industry with loan guarantees. It is hoped that such action would reduce pressure for further import protection.

Another innovative solution to the import car problem is being advanced by the Automotive Parts and Accessories Association and the Automotive Products Export Council and would entail a system that would credit foreign-based automakers with the value of U.S. content in their cars against the duty owed. This proposal (Parts Purchase Incentive Plan) would foster expanded international trade in automotive parts and probably boost U.S. export of parts. It is obvious that this approach would not rectify, by itself, the decline in assembly jobs due to import penetration but probably would add jobs in the parts producing sector.

These examples of alternative approaches to domestic content legislation now under consideration indicate that further productive deliberation is possible and probably necessary to fully explore the issue. As the debate moves forward, the political posturing evident in the debate's early phase could be filtered out in the course of reasoned discussion.

CONCLUSION

The issue of whether to institute a domestic content requirement for automobile manufacturers with substantial sales in the U.S. market is highly-charged and infused with controversy and resonable men disagree on the outcomes. Domestic content legislation would appear to stimulate production and employment in the recession-plagued U.S. auto industry, but possibly at the cost of "swapping" jobs in other sectors in the economy. Implementation of a content requirement could cause the United States to violate several of its international obligations and might provoke trade retaliation by foreign governments against U.S. exports. While it may be tempting to seek a short-term solution by approving protectionist legislation, it is in the long run interest of the country to encourage a careful debate of the issues and thoroughly explore reasonable alternatives to content legislation.

The Great Lakes region has a major stake in the automobile industry. Over half of the auto assembly plants are located in the region and many of the parts suppliers are also resident businesses. In 1982, the Great Lakes states accounted for over 55% of the total U.S. production. As auto production improves with the economic recovery, the lakes states should increase their production share. Along with motor vehicle assembly and parts production, the region is also the center of automotive steel production. For these reasons the economic health of the region is inextricably linked to the fortunes of the American auto industry.

Policies such as deregulation of the private sector, reduced taxes, provision of incentives for increased savings and investment, funding for research and development, along with a policy of export promotion could provide the impetus for domestic economic recovery without the need for protectionist trade measures. It is through the implementation of eocnomic policies that promote efficiency, productivity and competition at home and abroad that the Congress may help to revitalize the American economy. The final question Congress and the Administration must answer is whether (or not) domestic content legislation will accomplish these objectives.

SUMMARY QUESTIONS

1. What is meant by "Domestic Content" legislation?

   Domestic Content legislation requires that a certain proportion of the value of a product sold in the United States--in this case automibles--to have been produced domestically. All automobiles sold in the U.S. market would be required to contain a certain percentage (by value) of American parts and labor.

2. How is domestic content determined?

   The percentage of an automobile that must be produced domestically is determined by the domestic content ratio. This ratio is obtained by dividing the added domestic value --the value of domestic labor and parts--by the aggregate of production costs of all automobile products--motor vehicles and parts--sold by the manufacturer in the U.S.

3. Has import penetration caused the current problems for the U.S. auto industry?

   Imports have undoubtedly aggravated the auto industry's current problems. But a U.S. International Trade Commission report, issued in September 1980, concluded that a tremendous drop in total sales, and not the rise in imports, was the major reason for the industry's current problems.

4. Would domestic content legislation bind U.S. automakers as well as foreign manufacturers?

   At this time, it is unlikely that any U.S. automaker would run afoul of the proposed domestic content requirements. Major domestic producers (G.M., Ford, Chrysler, AMC) all have over 90 percent domestic content in their automotive products. However, domestically-based subsidiaries of several foreign car-makers (particularly Honda, Nissan, and VW) could be forced from the U.S. market. Moreover, as the economic rationale for "world car" production becomes more forceful, U.S. manufacturers would be unable to avail themselves of cheaper foreign intermediate subassemblies. Thus in the future, domestic content requirements would also constrain U.S. automakers as well as foreign producers.

5. What are the likely consequences if domestic content legislation is enacted?

   There are three major probable effects. First, there may be a net loss of employment as jobs in export and import-competing industries are "swapped" for jobs in the auto-producing sector of the economy. Second, the U.S. consumer may face as much as a 10 percent rise in the price of automobiles as competition is reduced. Finally, U.S. export industries may suffer further as our trading partners retaliate against a domestic content law.

6. Is growing protectionism a serious threat to the international trading system?

Yes. Protectionist measures reduce the flow of goods between nations, misallocating resources and engendering inefficiency. A "spiral effect" of retaliatory protectionism would destabilize the international trading system, similar to the most unfortunate circumstances that unnecessarily sparked and deepened the Great Depression during the 1930s.

7. Are there alternatives to domestic content legislation?

Yes. There have been many proposals--not all of them would accomplish the exact goals of content legislation but are allied in general thrust.

Some examples:

a) Import quotas -- voluntary, arranged through bilateral negotiations or unilaterally imposed.

b) Duties -- straight or arranged to be offset by incentive provisions such as value of U.S. content.

c) Government policies -- designed to encourage foreign investment in U.S., regulatory action intended to provide more favorable business climate and tax incentives.

d) Legislation such as H.R.3113 which would not immediately require content requirements but would preserve the option if other identified remedies did not satisfactorily address the problems of import penetration and U.S. auto industry productivity.

FOOTNOTES

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