Senate Democratic Policy Committee Hearing

"An Oversight Hearing on Trade Policy and the U.S. Automobile Industry"

Charles W. McMillion
President and Chief Economist, MBG Information Services

February 17, 2006

It's hard to overstate the importance of the car in the American economy and to the American culture. From mass production to middle class wages, to our preoccupation with speed, open spaces and mechanical tinkering, the production and maintenance of the automobile has had a profound effect on the US and on our role in the world for a century.

The US auto industry -- and therefore, the country -- faces a very dangerous crisis that is, as yet, barely visible in the economy outside Michigan and Ohio. Despite a booming market for their product, financial markets consider GM and Ford's borrowing status to be "junk." Trade policies that have been championed by the auto industry are one major cause of the crisis.

(Slide 1) The industry has been selling a record 17-18 million vehicles per year in the US in each of the last seven years. And US producers have been assembling a record of about 12 million vehicles per year in the US in each of the last nine years.

(Slide 2) Of course this means that in each of the last seven years the US had net imports of about 5 million vehicles and that domestic assemblies would have needed to be about 40% greater to meet domestic demand. Still, as the graphic shows, it was far worse in the mid-1980s.

(Slide 3) It's also important to note that while auto industry job loss has been severe over the past five years, jobs in the industry actually peaked in 1999...or 2000 depending on whether we use the now-discontinued SIC industry definition or the new North American NAIC. I attribute much of this to production incentives through the industry's labor agreements.

(Slide 4-6) I have 3 graphics showing that overall growth of auto industry production has -- because of these labor incentives, I believe -- kept up with US demand growth except for a falloff during 2000 and 2001. The bottom line here is that so far the industry seems to have lost "only" about 108,000 jobs to net imports since 1993. The production and job performance has been far stronger than many realize; a fact I've noted that I attribute to the production incentives in now-threatened union contracts.

(Slide 7) Shows the more expected pattern for the Textile and Apparel industry that has little effective union presence and where production has plunged, displaced by net imports, and job loss has been severe. This is the pattern that the auto industry could face if labor's production incentives are removed in the years ahead through bankruptcy courts or by other means. And, of course, the fate of the auto and auto parts industry affects a very wide range of supporting goods and services industries.

(Slide 8) Now a little context: Our manufacturing trade deficit last year was -$506 billion and totals over $2 trillion in just the last five years. The Current Account deficit, of course, of all goods and services was about $800 billion in 2005 and totals almost $3 trillion over the last five years; a little more than the budget deficits.

(Slide 9-10) One of the key reasons for the widening deficits have been trade deals that are producing very different results than were promised. Nafta, for example, was sold to Congress with the help of some economists promises it would result in an ever widening excess of US production and trade surpluses with Mexico. It hasn't worked out that way and in fact we've now accumulated Current Account deficits with Mexico of almost $400 billion since Nafta -- rather than the $100 billion job-creating surpluses that were assured.

(Slide 11) Even with the production incentives of labor agreements, the dollar value of auto trade deficits has worsened badly in recent years, from $50 billion in 1993 to $138 billion in 2005. But, so far, the industry's share of the total annual US trade deficit has been declining.

(Slide 12) I've summarized the auto trade balances with major trading partners -- although the Dept. of Commerce doesn't yet include China for these data. This shows the continuing auto deficits with Japan and Germany as well as the explosion of the auto deficit with Mexico since Nafta. You might also note that while our deficits in autos and trucks stabilized last year, the US deficit in auto parts soared by more than 20%. Much of the growth in auto parts imports is now coming from China.

(Slide 13) I want to remind you to beware of a particularly outmoded economic theory that aggregates the productivity of both traded and non-traded goods to ridicule concerns about US trade with very low cost countries like Mexico or China. This is not how businesses plan, policy makers shouldn't either. Mexico now exports more vehicles to the US than the US exports to the world.

(Slide 14) I've followed China very closely for a long time and it's my believe that for the foreseeable future, its challenge to the US auto industry -- and most other industries -- will dwarf anything we've seen before. I've provided a brief sketch of a few of the signposts along the way during our past 25 years of commercial relations with China.

(Slide 15) And finally, I've provided China trade detail for all US goods industries for the last dozen years. (I'm happy to talk about service industry trade, too, although that's quite small with a US surplus of about $2 billion -- much of it for educating Chinese students.) You might note that about halfway down the first page of the table is HS 87 "Vehicles..." you'll see that the US deficit is rising fast but from a small base -- and about half of this is still bicycles, motorcycles and baby carriages. But this is about to change very quickly in the way that computers and electronic equipment has changed at the top of the page.

China's 11th Five-Year Development Plan through 2010 is to produce an abundance of auto parts and 10 million vehicles for export each year by 2010 -- enough to virtually eliminate the US industry as has already been done for most US production of cell phones, computer parts and other key products of the future. We haven't begun to feel the effects of this on the US economy but it is coming and it is coming fast.