THE WHITE HOUSE

WASHINGTON

CABINET COUNCIL ON COMMERCE AND TRADE

October 26, 1983

8:45 a.m.

Roosevelt Room

AGENDA

1. Status Report on the U.S. Auto Industry (CM#155)

2. Working Group Recommendations for Approving the Administration of the Textile and Apparel Import Program (CM#386)

Auto Ind Status
= reporting record earnings, but not accurate reflection of true picture =
pot'l wage prots, esp for
= in better shape, but too soon to say they're out of the woods
Domestic Content = too close to call in House = each side has about 200 votes
W&Mns reported bill ~~sent out~~ w/ unfav. = vote soon
test next wk = "chance to beat it"

THE SECRETARY OF COMMERCE
Washington, D.C. 20230

MEMORANDUM FOR: Members of the Cabinet Council of Commerce and Trade

FROM: Malcolm Baldrige
Chairman Pro Tempore

SUBJECT: Status Report on the U.S. Automobile Industry

This is the latest in a series of reports on the status of the U.S. auto industry. It focuses on two questions:

- How has the U.S. auto industry benefited from the economic recovery?
- To what extent has the recovery served to restore the industry's competitive position?

The answers, in short, are that:

- The industry has derived significant benefits from the economic recovery -- profits have been restored and unemployment has declined, but
- These short-term improvements have not been sufficient to eliminate the damage done to the industry's competitive position over the last four years.

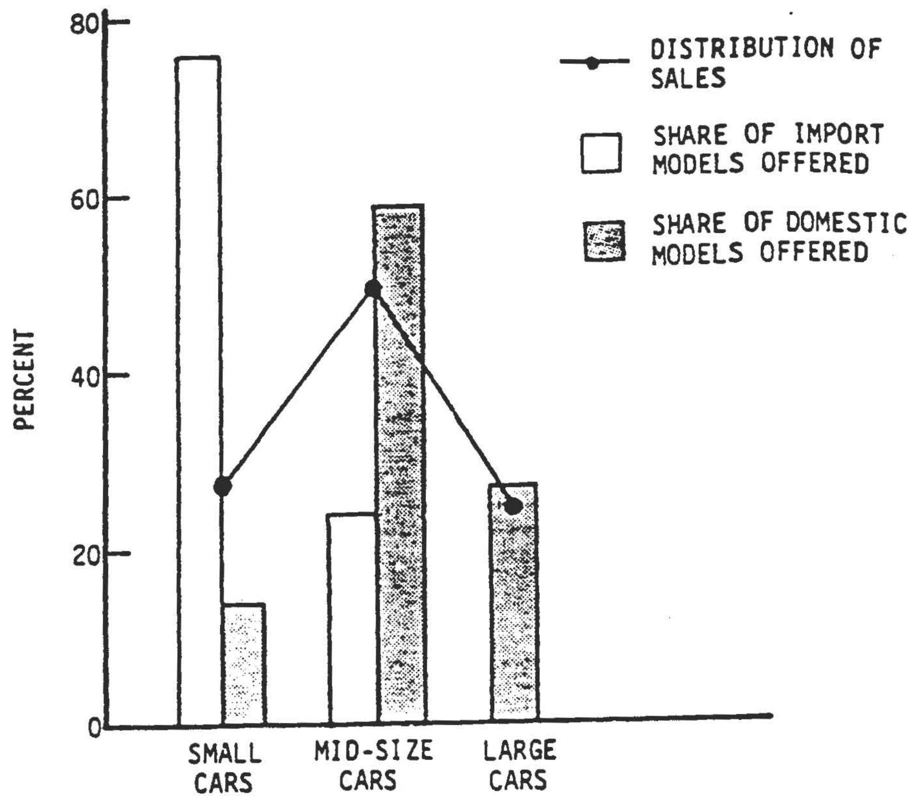
Background

Between 1978 and 1982, the U.S. auto industry experienced its greatest losses since the Great Depression, but made record investments to develop new products at the same time. This high level of investment $51.3 billion over five years, was needed to adapt to a shift in the U.S. market. The successful adaptation is illustrated in the tables below. Table I shows the distribution of sales between small, mid-size, and large cars in 1978. Table II shows the situation in 1982. The percentages of the total number of models offered by both the domestic and imported car manufacturers in each class are compared to the sales distribution. The conclusions are striking.

Table I

U.S. Car Market: Sales Distribution vs. Model Offerings, 1978

1978

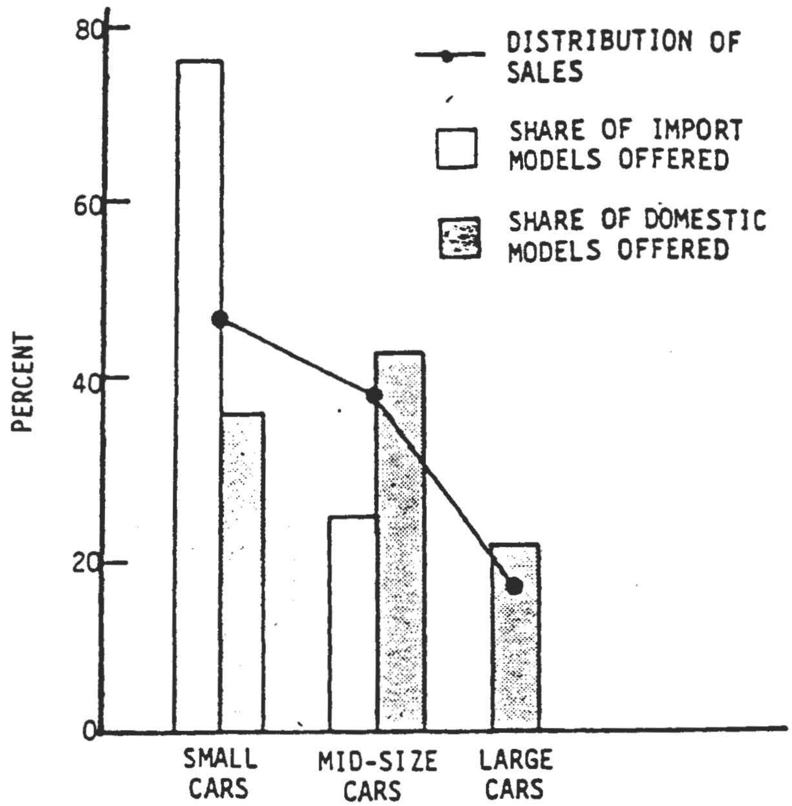


In 1978, the profile of consumer demand was clearly centered in the mid-size car segment. Almost 50 percent of all sales were in this area. Model offerings by the U.S. companies closely matched consumer demand, while the profile of imported model offerings was significantly out of line with demand. Seventy-six percent of imported models were in a market segment which accounted for only 27 percent of consumer demand. The U.S. industry had a very large proportion of the market free of significant foreign competition. Coincidently, the U.S. industry had record profits of $4.8 billion.

Table II

U.S. Car Market: Sales Distribution vs. Model Offerings, 1982

1982



In 1982, the profile of consumer demand had shifted noticeably toward small cars. Almost half of all the sales were in this segment. The U.S. industry was successful in shifting the profile of its model offerings to match the change in consumer demand. Yet, the profile of imported model offerings had not changed at all (although the number and variety of models had increased). Thus, the recession and gasoline price increases triggered a series of shifts; first by the consumer then by the U.S. manufacturers. The current fit between domestic product offerings and consumer demand is almost as good as in the 1970's. But, a permanent change occurred. The U.S. industry now faced foreign competition in 85 percent of the market.

The high cost of shifting the product line to follow the market coupled with low sales also forced the U.S. manufacturers to improve their operating efficiency. An example of the improvement is shown in Table III. It illustrates that during a period of declining sales (1980-1982), the gross margin per unit nearly doubled.

Table III

Costs* and Revenue Per Unit
GM, Ford, and Chrysler Combined

	1980	1981	1982
Revenue/unit	$8,173	$8,975	$9,171
Costs/unit	7,538	7,989	7,929
Gross margin/unit	$ 635	$ 986	$1,245

*"Costs" includes costs of goods sold and other operating charges such as retirement programs. It excludes selling, general, and administrative expenses; depreciation; net interest expense; and minor sources of income and expense.

Source: Company annual reports

Thus, by 1982, the U.S. industry had the product offerings and cost structure to enable it to benefit from the recovery of the country's economy.

How has the U.S. Auto Industry Benefited from the Economic Recovery?

Sales

The recovery in U.S. auto sales began last year and has continued to strengthen. On a seasonally adjusted annual basis, 1982 U.S. auto sales reached a low point in June at 7.3 million units. By October 1983, seasonally adjusted sales had improved 26 percent to 9.2 million units. For the year, we expect total U.S. auto sales to be 9.2 to 9.3 million units. This should increase to the 10.2 to 10.4 million unit range next year.

Financial Indicators

The improvement in sales has been reflected in the domestic industry's financial position. From 1978 to 1982, for example, the U.S. companies had a cumulative funds deficit from operations of almost $31 billion ($11 billion of that was in 1980 alone). The deficit has been declining and, for the first six months of 1983, was only $360 million. For 1983 as a whole, we expect a funds surplus from operations.

In the third quarter, 1979, the industry reported its first industry-wide loss in almost 5 years. Ten of the next 13 quarters were to be losses. In fact, by March 1982, the cumulative earnings since January 1979 was a loss of $2.6 billion. In December 1982, the cumulative loss was still $2.2 billion. Yet in only six months of this year, the industry offset these losses with $93 million "to spare".

U.S. manufacturers weathered the period only by selling assets; acquiring U.S. Government assistance; or from the earnings of non-auto and overseas operations. It was only these sources that allowed the industry to show a $322 million profit in 1982. The 1982 income from automotive operations was a $1.435 billion loss. This weakness has begun to reverse because of the industry's cost control efforts and the economic recovery. For the first six months of this year, net income was $2.29 billion, with automotive operations contributing $1.946 billion.

Third quarter earnings will be reported in early November. We expect the industry to report a profit of about $1.0 billion. For the year, earnings could approach $5.0 billion.

Employment

In 1978, employment in the U.S. auto industry averaged 1.03 million workers over the year. The low point was 631,000 at year-end 1982. Industry employment is currently estimated to have increased 11.7 percent to 705,000 workers. (Production for January-September 1983, is 21 percent above the equivalent period last year, illustrating the increase in productivity that has occurred.) Indefinite layoffs reached a peak in January 1983 at 269,000; they are currently 132,000, or 51 percent lower.

In summary, the last year has seen a remarkable improvement in the earnings and employment of the U.S. auto manufacturers.

Has The Recovery Been Sufficient To Restore The Industry's Competitive Position?

No. The industry has accomplished much, but in doing so its financial strength has been weakened. One year of earnings has not been sufficient to offset four years of record losses. Attached are the combined balance sheets for GM, Ford, and Chrysler as of December 31, 1978, and June 30, 1983, as well as a percentage analysis of the two. The salient features are:

- Working capital has declined from $12 billion in 1978 to $2.7 billion in 1983.

- This has been accompanied by a decline in corporate liquidity. In 1978, current assets accounted for nearly 57 percent of total assets. This fell to about 43 percent in the first half of 1983. Over the same period, investment in Property, Plant, and Equipment has risen from 32 percent of total assets to over 43 percent.

- Long-term debt has more than doubled in absolute terms ($3.3 billion in 1978 vs. $7.0 billion in 1983), rising from 5.6 percent of total liabilities in 1978 to 9.4 percent in 1983.

- Debt due within one year has almost tripled (from $929 million to $2.6 billion). As a proportion of total liabilities and stockholders' equity, it has grown from 1.6 percent to 3.5 percent.

- The net assets of the industry (the equity of its stockholders) has been significantly reduced. In 1978, stockholders' equity was equal to over 50 percent of total assets. By June 30, 1983, this had declined to about 37 percent.

In order to satisfy stockholders and capital markets, the auto companies must allocate a significant proportion of earnings to retire debt, improve working capital, and restore dividends. These expenditures, in the short run, contribute nothing toward new product development. Thus, the ability of the auto companies to compete will be much less than reported income might indicate. If, in addition, discretionary labor and material costs also are allowed to rise, the benefit of increased sales will be further diluted.

Competitive Strength

While rebuilding their strength, the domestic manufacturers must also face direct competition across most of the market. Their ability to succeed depends, in part, on the ability of the foreign manufacturers to develop new products and to adapt to changing market conditions.

Accordingly, we compared several financial indicators for Toyota, Nissan, Honda, GM, and Ford for 1979-1982. Three indicators are shown below in Table IV. Even though the period covered includes the U.S. recession and two years of limits on Japanese auto exports to the U.S., the Japanese companies were able to maintain their financial reserves.

Table IV

Financial Indicators

	1979	1980	1981	1982
Net return on sales				
GM	4.4%	(1.3)%	0.5%	1.6%
Ford	2.8	(4.2)	(3.0)	(2.0)
Japan*	2.7	3.2	3.0	2.7
Long-term debt as a share of long-term capital**				
GM	4.4%	9.6%	12.4%	19.6%
Ford	10.9	19.4	26.9	27.9
Japan*	15.7	13.9	11.2	15.6
Return on long-term capital**				
GM	12.2%	(2.5)%	2.0%	2.5%
Ford	7.5	(10.0)	(3.0)	(3.5)
Japan*	9.1	10.3	10.1	8.1

*The average of Toyota, Nissan, and Honda.
**Long-term capital consists of long-term debt and stockholder's equity.

The net return on sales for the Japanese companies has held steady, while GM and Ford have yet to recover to a comparable level. Long-term debt as a share of long-term capital is even more striking. The Japanese companies have held their position. (Toyota, for example, is debt free.) GM and Ford have gone from being significantly stronger than the Japanese in 1979 to significantly weaker in 1982. The same relationship holds for return on long-term capital. The performance of the Japanese companies would be stronger if one were able to consolidate the earnings of their subsidiaries.

Because the Japanese auto manufacturers have not suffered a comparable deterioration in financial strength, they will not have to allocate significant portions of future earnings to improvement of their balance sheets. Thus, the U.S. auto companies are not in a position to use fully their expected earnings to improve their product offerings nor do they have the financial reserves to adapt to further shifts or downturns in the market. Their Japanese competitors, on the other hand, are free to concentrate their resources on new product development.

Attachments

Consolidated Statement of Financial Position[1]
General Motors, Ford, and Chrysler
(Percent)

Assets	Dec 31 '78	June 30 '83
Current Assets		
Total Cash & Marketable Securities	10.89%	12.78%
Accounts & Notes Receivables (Less Allowances)	17.54	11.75
Inventories (LCM & Less Allowances)	25.48	14.36
Other Current Assets	2.95	3.77
Total Current Assets	56.86	42.68
Non-Current Assets		
Equities in Net Assets of Unconsolidated Subsidiaries and Affiliates	9.85	11.17
Other Investments & Misc. Assets	1.38	2.68
Property, Plant & Equipment	31.91	43.45
Total Assets	100.00%	100.00%
Liabilities and Stockholders' Equity		
Liabilities		
Current Liabilities		
Accounts Payable	17.28%	13.86%
Other Payables	2.43	2.81
Debt Payable within 1 year	1.56	3.45
Accrued Liabilities	15.29	18.84
Total Current Liabilities	36.55	38.97
Other Liabilities		
Long-term Debt	5.55	9.44
Deferred Taxes	2.33	3.81
Capitalized Leases	0.03	0.40
Other non-current Liabilities	4.97	10.62
Total Liabilities	49.43	63.27
Stockholders' Equity		
Preferred Stock	0.84	0.68
Common Stock	1.87	3.24
Additional Paid-in Capital	3.30	4.45
Foreign Currency Translation Adjustments		2.04
Retained Earnings	44.56	30.39
Total Stockholders' Equity	50.57	36.72
Total Liabilities and Stockholders' Equity	100.00%	100.00%

[1]This is not a formal consolidation since intercompany transfers were not eliminated. Thus, receivables and payables are somewhat overstated.

Attachments Continued

Consolidated Statement of Financial Position[1]
General Motors, Ford, and Chrysler
As of December 31, 1978
(Dollars in Millions)

Assets			
Current Assets			
Cash		$ 422	
Marketable Securities (LCM)		6,080	
Total Cash & Marketable Securities			$ 6,502
Accounts & Notes Receivables (Less Allowances)			10,467
Inventories (LCM & Less Allowances)			15,205
Other Current Assets			1,758
Total Current Assets			33,932
Non-Current Assets			
Equities in Net Assets of Unconsolidated Subsidiaries and Affiliates			5,879
Other Investments & Misc. Assets			823
Property, Plant & Equipment			
Real Estate, Plant & Equipment (at cost)	$37,888		
Less: Accumulated Depreciation	22,027		
Net Real Estate, Plant & Equipment		$15,861	
Unamortized Special Tools		3,187	
Total Property, Plant & Equipment			19,048
Total Assets			$59,682
Liabilities and Stockholders' Equity			
Liabilities			
Current Liabilities			
Accounts Payable			$10,311
Other Payables			1,451
Debt Payable within 1 year			929
Accrued Liabilities			9,123
Total Current Liabilities			21,814
Other Liabilities			
Long-term Debt			3,312
Deferred Taxes			1,390
Capitalized Leases			15
Other non-current Liabilities			2,967
Total Liabilities			29,498
Stockholders' Equity			
Preferred Stock			501
Common Stock			1,118
Additional Paid-in Capital			1,968
Foreign Currency Translation Adjustments			---
Retained Earnings			26,597
Total Stockholders' Equity			30,184
Total Liabilities and Stockholders' Equity			$59,682

[1]This is not a formal consolidation since intercompany transfers were not eliminated. Thus, receivables and payables are somewhat overstated.

Attachments Continued

Consolidated Statement of Financial Position[1]
General Motors, Ford, and Chrysler
As of June 30, 1983
(Dollars in Millions)

Assets			
Current Assets			
Cash		$ 1,626	
Marketable Securities (LCM)		7,845	
Total Cash & Marketable Securities			$ 9,471
Accounts & Notes Receivables (Less Allowances)			8,710
Inventories (LCM & Less Allowances)			10,646
Other Current Assets			2,799
Total Current Assets			31,626
Non-Current Assets			
Equities in Net Assets of Unconsolidated Subsidiaries and Affiliates			8,282
Other Investments & Misc. Assets			1,987
Property, Plant & Equipment			
Real Estate, Plant & Equipment (at cost)	$58,690		
Less: Accumulated Depreciation	31,511		
Net Real Estate, Plant & Equipment		$27,179	
Unamortized Special Tools		5,012	
Total Property, Plant & Equipment			32,191
Total Assets			$74,086
Liabilities and Stockholders' Equity			
Liabilities			
Current Liabilities			
Accounts Payable			$10,269
Other Payables			2,083
Debt Payable within 1 year			2,556
Accrued Liabilities			13,965
Total Current Liabilities			28,873
Other Liabilities			
Long-term Debt			7,001
Deferred Taxes			2,829
Capitalized Leases			303
Other non-current Liabilities			7,870
Total Liabilities			46,876
Stockholders' Equity			
Preferred Stock			508
Common Stock			2,405
Additional Paid-in Capital			3,302
Foreign Currency Translation Adjustments			(1,521)
Retained Earnings			22,516
Total Stockholders' Equity			27,210
Total Liabilities and Stockholders' Equity			$74,086

[1]This is not a formal consolidation since intercompany transfers were not eliminated. Thus, receivables and payables are somewhat overstated.