THE VOLUNTARY EXPORT RESTRAINT (VER) AGREEMENT WITH JAPAN ON AUTOMOBILES IN THE 1980S

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ABSTRACT

Detroit went through a turbulent period during the 1970s and suffered tremendous financial losses in 1980. The governments of the United States and Japan worked out a VER agreement in 1981 to help Detroit get back on its feet. This article investigates the U.S. motor vehicle industry's problem in the early 1980s, examines supporting and opposing views on the VER agreement, reports how the VER agreement played out, and offers comments and suggestions.

Historically American auto companies together with their suppliers and distributors have provided good-paying jobs for hundreds of thousands of American workers. Automotive products have also affected many other important industries in the U.S., such as primary metal, machine tools, plastics, rubber, glass, tire, battery, and electronics industries. A strong U.S. motor vehicle industry has been essential to a healthy and prosperous U.S. economy.

According to the U.S. Department of Commerce, the big three American auto makers—GM, Ford and Chrysler—were profitable every year between 1958 and 1979. However, they experienced a huge pre-tax operating loss in the amount of $6.2 billion in 1980.[1] Meanwhile, the total import share of the U.S. new car market increased dramatically from 6.12 percent in 1965 to 28.20 percent in 1980, with Japanese-made vehicles accounting for about 80 percent of the import segment in 1980.[2]

In 1981, with the U.S. auto industry facing huge financial losses and Chrysler confronting bankruptcy, the U.S. government and the Japanese government negotiated a deal—a Voluntary Export Restraint (VER)—that required Japan to limit its auto exports to the U.S. on an unforced, willing basis. The primary purposes of the deal were to provide American auto firms time to retool in order to become more competitive, to generate funds to finance the U.S. auto industry's revitalization, and to save American jobs. In his book *The American Automobile Industry*, Rae recorded:

> The gasoline crisis of the spring of 1979 appears to have marked a watershed in the history of the American automobile industry. The long period when the United States had held undisputed first place in the automotive world came to an abrupt end. Even the giants like General Motors and Ford found themselves in a grim competitive struggle and faced with the necessity for making drastic and expensive changes in their operations.[3]

The objectives of this paper are threefold: (1) to investigate Detroit's problem in the early 1980s; (2) to present supporting and opposing views on the U.S.-Japan deal designed to restrict Japanese auto exports to the U.S.; and (3) to discuss how the Japanese so-called "voluntary export restraint" on automobiles played out. Some comments and suggestions are provided.

Detroit's Problem in the Early 1980s

The U.S. auto industry comprised three major companies (GM, Ford, and Chrysler) and one minor producer (American Motors) in the 1950s. These firms faced virtually no foreign competition in the U.S. until 1954, when the Volkswagen (VW) Beetle started to gain popularity. VW's sales increased continuously between 1954 and 1970, but de-

Table 1. Import Penetration of the U.S. Car Market, 1960-1984 (in millions unless otherwise indicated)

Year	Total new car registrations	Imports	Import share (percent)
1960	6.58	0.50	7.60
1961	5.85	0.38	6.50
1962	6.94	0.34	4.90
1963	7.56	0.39	5.16
1964	8.07	0.48	5.95
1965	9.31	0.57	6.12
1966	9.01	0.66	7.33
1967	8.36	0.78	9.33
1968	9.40	0.99	10.53
1969	9.45	1.06	11.22
1970	8.39	1.23	14.66
1971	9.83	1.29	13.12
1972	10.49	1.53	14.59
1973	11.35	1.72	15.15
1974	8.70	1.37	15.75
1975	8.26	1.50	18.16
1976	9.75	1.45	14.87
1977	10.93	1.98	18.28
1978	10.95	1.95	17.81
1979	10.36	2.35	22.68
1980	8.76	2.47	28.20
1981	8.44	2.43	28.79
1982	7.75	2.27	29.29
1983	8.92	2.46	27.58
1984	10.12	2.52	24.90

Source: *Automotive News: Market Data Book, 1985*, p. 26; quoted in Robert W. Crandall, et al., *Regulating the Automobile* (Washington, D.C.: The Brookings Institution, 1986), 11.

creased steadily between 1970 and 1984. While VW's sales in the U.S. went downhill after 1970, the Japanese auto makers—Toyota, Nissan, Honda, Mazda, and Suburu—were riding an upward sales trend in America.[4] As Table 1 shows, the import share of the U.S. car market passed 10 percent for the first time in 1968, and then exceeded 20 percent in 1979. In fact, Japanese car manufacturers substantially increased their market shares in many foreign markets in the 1970s (see Table 2).

Table 2. Japanese Car Import Penetration: Selected Countries (percent)

Country	1970	1978	1981
Australia	15.4%	33.3%	34.1%
Austria	0.9	7.0	25.4
Belgium	4.9	17.9	24.7
Denmark	3.4	13.7	24.2
Finland	18.3	20.4	33.0
France	0.2	1.8	2.6
West Germany	0.1	3.7	10.0
Italy	--	0.1	0.1
Norway	11.4	20.4	37.9
Sweden	0.7	9.7	13.7
Switzerland	5.6	12.6	26.9
Netherlands	3.1	19.0	24.4
United Kingdom	0.4	11.0	11.0
United States	3.7	12.0	21.8

Source: Motor Vehicle Manufacturer's Association, "World Motor Vehicle Data"; quoted in U.S. Department of Commence, *The U.S. Motor Vehicle and Equipment Industry Since* 1958 (Washington, D.C.: U.S. Government Printing Office, 1985), 18.

Automobiles and oil are complementary goods; the availability and price of gasoline definitely affect the total demand for cars and the types of cars preferred by customers. In the 1960s, with rapidly-rising oil consumption but gradually-dwindling domestic oil supply, the U.S. became a big oil-importing country. A war between Israel and its Arab neighbors broke out in October 1973, resulting in the 1973-1974 Arab oil embargo. When the embargo ended in 1974, the Organization of Petroleum Exporting Countries (OPEC) raised the oil price substantially and the price of gasoline jumped three- to four-fold. American consumers turned away from big "gas guzzlers," and the total new car sales in the U.S. fell sharply in 1974 and 1975.

The 1973-1974 Arab oil embargo and the U.S. government's control of oil prices through the Energy Policy and Conservation Act of 1975 sent confusing signals to American car buyers and created a great deal of uncertainty for Detroit's product planners. By late 1975 Americans' worry about oil shortage had eased off. Car sales in the U.S. rebounded during the 1976-1979 period and the consumers showed interests in larger models. Douglas Fraser, who became the president of the United Auto Workers (UAW) in 1979, reported that the auto industry, as late as February or March of 1979 ...was selling practically all the cars we could build. It was selling every single large car that could be built. The American people were not buying small cars. They had 150,000 Datsuns on the shores that they couldn't sell, about 75,000 Toyotas that they couldn't sell; and there was a reason for this. The reason is the American people simply wanted larger cars.[5]

The tide changed again in the spring of 1979, when the Iranian Shi'ite cleric Khomeini overthrew the U.S.-supported Reza Shah Pahlavi regime and established the Islamic Republic of Iran. This led to a five-percent reduction in crude oil imports which prompted the second oil crisis in the 1970s for the United States. According to automobile historian Rae, "in a matter of a few weeks the American public's preference in passenger automobiles changed radically and apparently permanently. Large cars became unsalable, and there was a stampede toward compacts, which the domestic manufacturers could not satisfy because they had not anticipated any such drastic changes in demand."[6] When their preferences for smaller cars could not be met by Detroit, a large number of American consumers bought imports, which by this time were largely from Japan. The import share of the U.S. car market rose from 17.81 percent in 1978 to 22.68 percent in 1979, and then to 28.20 percent in 1980 (see Table 1).

By 1980 it had become clear that American auto makers were not internationally competitive in terms of product quality, fuel efficiency, product innovativeness, production process techniques, and labor costs.[7] The findings of a survey of American automotive engineers showed that 48.5 percent of respondents gave top honors, in terms of product quality, to the Japanese, 27.2 percent to the Americans, and 23 percent to the West Germans.[8] The stratified-charge engine and the NAPS-Z (Nissan Anti-Pollution System) engine were developed by the Japanese. European cars were equipped with front-wheel drive and disc brakes earlier than American cars.[9] The Japanese auto manufacturers set up their production systems in such a manner that engines, axles, and other parts were delivered to the assembly line just in time, thus saving them hundreds of dollars per car in storage and carrying expenses.[10] In 1980, the inventory costs per vehicle produced by GM, Nissan, and Toyota were about \$1,000, \$350, and \$100, respectively.[11]

Part of Detroit's international competitiveness problem around 1980 was caused by the UAW's undue demand for higher wages and fringe benefits without commensurate productivity improvement. While the Japanese auto worker compensation was only 23 percent above the Japanese manufacturing average in 1980, the American auto worker received a 65 percent premium.[12] There also existed a significant difference of wage levels between the U.S. and Japan at the time. The ratio of the average hourly compensation between American auto workers and Japanese auto workers in 1980 was approximately 2 to 1.[13]

Contrary to a widely held belief, the exchange-rate changes between the U.S. dollar and the Japanese yen in the 1970s did not play a major role in causing Detroit's competitiveness problem in the early 1980s. The value of the U.S. dollar fluctuated dramatically against the currencies of fifteen other major industrial countries during the 1970-1990 period. However, the exchange-rate relationship between the U.S. dollar and the Japanese yen over the same period was an exception, with the Japanese yen steadily appreciating against the U.S. dollar.[14]

As Japanese competitors' market share in the U.S. rose quickly in the early 1980, the UAW and Ford Motor Company petitioned the U.S. International Trade Commission (ITC) for import relief, urging the government to raise tariffs on cars or set a quota on imported vehicles. In November 1980, the ITC ruled against this petition. The case was appealed to the incoming President Ronald Reagan and the Congress. Both the Japanese auto firms and the Japanese government tried to ward off any U.S. trade restrictions by arguing that automobile import business created many jobs for Americans and that Detroit would recapture its lost market share after U.S. auto makers started producing smaller models in quantity. In February 1981, Senators John Danforth and Lloyd Bentsen introduced legislation to impose a 1.6 million import quota on Japanese autos and received solid support from their colleagues in the Senate.[15]

In the spring of 1981, the Reagan administration found itself being caught between a rock and a hard place. On the one hand, the President was a strong supporter of free trade and did not like to place a protectionist quota on Japanese autos. On the other hand, President Reagan encountered a high probability that Congress would override his veto. Eventually, the Reagan administration let it be known that a voluntary export restraint from Japan would be acceptable. The then U.S. Trade Representative William Brock told Japanese government officials: "It takes 5, 6 or 7 years to retool to a completely new market demand. It would be appreciated if Japan would restrain (auto exports to the U.S.) for a limited period of time—3 or 4 years."[16] The Japanese side agreed. On May 1, 1981, a quota of 1.68 million vehicles per year for a two-year period was announced. Japan's Ministry of International Trade and Industry (MITI) was tasked to implement the VER agreement.[17] A government official in the Reagan Administration, Clyde Prestowitz, Jr. offered the following penetrating, insightful comment:

> If Congress were to impose quotas, it would determine how many cars Japan could sell in the U.S. market, under what conditions, and for how long. Moreover, if the Americans were smart, they would impose tariffs and take for themselves the excess profits that would accrue as prices on Japanese cars rose in response to the limited supply. On the other hand, if Japan were voluntarily to limit the shipments, the amounts, duration, and conditions would all be subject to negotiation and thus be much more under Japan's control. Moreover, the benefit of the price increase would accrue to Japan, which would also acquire a lever—namely, the possibility of dropping the restraint in future negotiation with the United States. . . . Japan, with its pragmatic approach to free trade, kept the initiative and the money; and the United States was able to maintain the fiction of being a free-trader without having to be one.[18]

Supporting and Opposing Views on the 1981 VER Agreement with Japan

There was no consensus among Americans on the 1981 VER agreement with Japan. Among President Reagan's Cabinet members, Commerce Secretary Malcolm Baldrige and Transportation Secretary Drew Lewis supported it while Secretary of State Alexander Haig and Treasury Secretary Donald Regan opposed it. The major arguments for the VER accord were: (1) the auto industry was crucial to the nation's long-term economic prosperity and national security; (2) Detroit's problem was partly caused by the two oil crises, which were basically brought about by the U.S. foreign policies in the Middle East; (3) Japan's auto market was a very closed one; and (4) all governments in the world supported and protected their domestic industries to some extent.[19] Congressman John LaFalce, chairman of the Economic Stabilization Subcommittee, in 1983 argued, "Foreign governments often assist their basic industries in many ways that are either prohibited here or simply not practiced here. For example, Japan and France provide cheap public capital for investment in potential growth areas. Virtually all of our major trading partners have programs to subsidize, protect or promote their industries while American firms most often compete as isolated entities."[20]

The primary arguments against the VER accord were: (1) free trade would allow American consumers to buy the vehicles they desired at the lowest possible prices; (2) the VER agreement would lead Detroit to make the necessary changes in the U.S. auto industry at a slower pace; (3) the VER agreement might provoke retaliation from Japan; and (4) Detroit should pay for its own shortsightedness and lack of international competitiveness.[21]

How the VER Agreement Played Out

In terms of its implementation, the VER agreement went into effect on April 1, 1981. The depressed U.S. car market in 1981, 1982, and 1983 (see Table 1) kept Japanese auto exports confined to 1.68 million vehicles per year during this three-year period. For 1984, the two countries agreed to raise the quota to 1.85 million vehicles.

The financial condition of the U.S. auto industry improved greatly in 1984. As a result, the U.S. government decided to let the VER agreement end in March 1985. Being sensitive to the protectionist sentiment in the U.S., the Japanese government chose in 1985 to adhere to a quota of 2.3 million units per year. This quota finally came to an end in 1994.[22]

To maximize revenues and profits under the VER constraint, Japanese auto manufacturers changed their export strategy and shipped more luxurious and pricier autos to the United States. This change of strategy actually helped improve the image of Japanese vehicles in the minds of American consumers.[23]

The VER agreement also led several Japanese automakers to make manufacturing investment in the United States. Honda Motor Company began assembling cars in

Ohio in 1982. Nissan opened an auto factory in Tennessee in 1983. Toyota and GM set up a joint venture in 1984 to build cars together in California. Toyota's Camry production began in 1988 in its wholly-owned plant in Kentucky. By early 1990, four other Japanese auto makers—Mazda, Mitsubishi, Isuzu, and Subaru—were also producing vehicles in America.[24]

The combination of the 1981 VER agreement with Japan and the various actions taken by Detroit in the early 1980s produced encouraging results: Detroit's car size, car weight, and breakeven points went down; its fuel efficiency, labor productivity, and profits went up.[25] In September 1983, Douglas Fraser said, "Things have changed for the better in the auto industry . . . the breakeven point in all of the auto companies is much lower than it was. . . . There's a new spirit of cooperation taking place in the auto industry—less adversarial. . . which lends itself to better quality and greater productivity."[26]

According to a U.S. International Trade Commission's report, the impacts of the VER on the U.S. auto market for 1984 include:

- Price increase of Japanese autos sold in the U.S.: $1,300
- Price increase of U.S. autos sold in the U.S.: $660
- Decrease of Japanese autos sold in the U.S.: 1 million units
- Decrease of Japanese share of the U.S. auto market: 9.6 percent
- Increase of U.S.-produced autos: 618,000 units
- Increase of U.S. auto industry jobs: 44,000[27]

Comments and Suggestions

The business environment is changing all the time; therefore it is important to anticipate the possible shifts in the future and to be one step ahead of times. Granted that no company can always foresee the challenges it will have to face, alert management should be quick in recognizing looming problems and take timely, appropriate actions. The Japanese car makers emerged as important competitors in the U.S. small-car market in 1965. To some degree, at least, Detroit can be criticized for responding to the Japanese challenge too slowly and too ineffectively.

In a free-market economy, customers generally try to make the best buy—to get the best vehicle at the lowest price. American auto companies should regularly research the market to find out customers' needs, wants, likes and dislikes, know Japanese competitors' strengths, weaknesses, objectives and strategies, develop the right products, produce quality autos, improve operational efficiency continuously, and charge a competitive price. To compete and win, Detroit must objectively identify its own weak spots and then strive to make improvements in those areas.

To build high-performance teams and get all the employees motivated to do their very best, U.S. auto makers need to improve their management-labor relationships. Detroit's management should be open-minded and should encourage all the workers to make constructive suggestions. In 1981 Toyota's workers submitted 1.4 million suggestions—30.5 per person—and 94 percent of them were accepted by the company. Mr. Soichiro Honda, who founded Honda Motor Company in 1948, said, "An industry prospers only when everybody involved in it thinks about how it can be improved."[28]

Free trade must also be fair trade. The auto trade between Japan and the U.S. should be free in both directions. If Japanese auto firms are allowed to export vehicles freely to the U.S., American auto firms should be allowed to export vehicles freely to Japan too. Lee Iacocca, who led Chrysler Corp. between 1979 and 1992, pointed out, "In America's determination to establish and hold ties to Japan and maintain it as a Far East buffer against Communism, the United States set trade agreements without thought to reciprocity."[29] Donald E. Petersen, president and then chairman of Ford Motor Co. in the 1980s, reported his observation and his company's experience as follows:

> As Japan got stronger, its government eliminated many of the laws against foreign investment, but it resorted to a highly developed system of impediments that still make it very difficult for Americans to export products to Japan or set up facilities there. . . . For much of the '70s and '80s, there was no way to slice through all the paperwork. Each and every car had to go through a maze of approvals. In Japan, you have to sell cars door to door. But our salespeople wound up sitting around the import authority office waiting for permission to bring their cars in. The officials were extremely adept at being out to lunch or taking a tea break. Days could go by, and a salesman who is stuck at the import office isn't selling any cars.[30]

The U.S. government was guilty of negligence for not forcing Japan to truly open its auto market. Consequently, American auto firms did not have an opportunity to compete with Japanese auto firms on an even basis. The U.S. government should replace its ideologically driven "free trade" policy with a more sensible, pragmatic "free and fair trade" policy.

Notes

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