Surveying the vital economic indicators affecting the automotive industry

Business, Industries

Surveying the Vital Economic Indicators Affecting the Automotive Industry

The automotive market in the US is the largest in the world and it continues to squeeze out growth today. However, many US manufacturers offered heavy rebates and no-interest financing recently, which pushed sales up, but with decreased margins. By late 2001, the US economy was showing signs of stagnation. To bolster sales, the US automotive industry (with GM leading the charge) began a campaign of heavy discounting in the form of 0% financing and huge cash-back incentive programs. This helped the automotive makers through the recession, only to face new adverse conditions in rising oil and healthcare costs (Economic Intelligence Unit., 14 December 2005).

As an industry, the automotive industry produces common resources where price elasticity of demand is elastic. When speaking of automobiles, it generally means cars. Having a new car is just one option in all available modes of transportation; since there are many substitutes, like taking a bus or train or buying cheaper vehicle, like a bicycle or motorcycle. More importantly, people nowadays prefer to buy used cars. In fact, wholesale prices of used vehicles in 2005 showed their largest annual percentage gain in nine years. Overall, used-vehicle prices rose 4. 6 percent last year over 2004 (Sawyers, 26 January 2006). Thus, upon viewing all possible cheaper alternatives, choosing to have a new car is considered to be a luxury.

When the automobile prices increase, many people would delay buying new cars since they could settle for used or their own old cars. In this case, quantity demanded would be very sensitive to a change in price, in

consideration of a short run perspective. However, an old car wears out and must be replaced, so quantity purchased will pick up again. Thus, if taking this in a long run perspective, price elasticity of demand is less than short run. If the price of automobiles decreases this year, then that will increase the willingness of people to buy the latest car models. According to the Economist Intelligence Unit (December 14, 2005), the U. S. demand for cars usually rise by 4% annually. Since the U. S. is the largest manufacturer of passenger cars and light trucks in the world, with its output of 11. 8 million units in 2003 accounting for over 20% of world production, this will augment the purchase of new cars this year significantly. Therefore, in a short period of time, quantity demanded is very sensitive to the change in price. However, once the stock is rebuilt, people will stop buying new cars because people will only buy new cars to replace old cars Therefore, in a long period of time, demand is less elastic.

Transactions of a buyer and seller directly affect the seller, buyer, and a third party in the automobile industry. It is a positive externality for the buyer and seller for these reasons. The Seller has done their job and mademoney. The buyer now has something to increase the speed and convenience of their transportation. The negative externality for all three would be the exhaust that the vehicle emits into the ozone. This would affect the buyer and seller along with everyone else who breaths air. In simple terms as long as there is carbon monoxide being sent to the ozone it affects everyone no matter which part of the sale of the vehicle or third party. This is the major negative externality of the automotive industry. Automakers and suppliers are also affected by the season. Operating results vary primarily because of the

variability in types and numbers of vehicles sold in different seasons. In addition, results are affected by new product launches, sales incentives, and costs of materials and production changes.

Furthermore, wage is major issue in the automotive industry, especially now that we are entering in fast-changing times characterized by the influx of global trade. The management is always concerned with wage and benefit issues because its ability to compete depends to some extent on its labor costs. Firms producing equivalent output with lower labor costs will have higher profits and be better able to operate during downturns. Both labor and management are concerned about a variety of pay aspects. Wage inequality is measured with the overall level of pay, but it is also concerned about how pay rates and pay increases are determined for different jobs and about the mix of wages and benefits paid to employees.

With such issues, labor unions attend to bargaining with the management to forge in other industries but, because of global competition and deregulation, upward pattern bargaining across industries has declined. While not denying employers' rights to a return on investment, unions would not necessarily agree that profit maximization is a firm's primary goal. Unionization aims to increase the power of workers to increase their share of the firm's revenue. Unions also want uniformity in wage rates for the same jobs in different locations of the same company. When profits are increasing, unions expect to receive pay increases. They avoid accepting reduced pay when profits decline, but may concede when employers have incurred substantial losses and job losses for union members would be the

alternative. Some internal union critics have condemned concessions, arguing that past labor leaders would not have accepted them. As long-time UAW president Walter Reuther's speeches, the UAW president condemned initial auto concessions in the early 1980s.

Labor issues in the automotive industry is handled by the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW), one of the largest and most diverse unions, with members in virtually every sector of the economy. According to their website, the UAW represents skilled trades and production workers at General Motors, Ford and Daimler-Chrysler. In addition, the UAW represents several thousand salaried employees — including engineers, designers and draftsmen — at DaimlerChrysler, Ford and General Motors. Workers at new United Motor Manufacturing Inc. (NUMMI), a GM-Toyota joint venture; and Mitsubishi Motor Manufacturing of America Inc. (MMMA) also belong to the UAW. The UAW, through negotiations, has reluctantly followed the transplants by agreeing to lower wages in the automotive industry, but so far, only in supplier plants. In all reality, they have no choice. Once the down-spiral starts, everyone is pulled into the breaking of the U. S. automotive industry wage structure by the transplant managements, facilitated by the anti-union stance of the transplant workers, opened the US wage-loss gates considerably wider than those of other old-line, union-contracted, automotive-producing countries. In UAW's perspective, globalizationhas caused this impact on worldwide labor rates, both for those who sweat and those who use keyboards. Non-union people will take the brunt, as wages and benefits for both workers and retirees are diluted to meet the twin challenges of globalization and

management decisions. Using the CPI, real wages for automotive production workers in the United States have fallen since 1970.

Recently, New York Times (Peters, 28 March 2006) reported that labor unions has approached the auto parts supplier Delphi to propose giving its factory workers $50, 000 in exchange for a 40 percent reduction in pay, according to union officials. The plan also calls for General Motors, which spun off Delphi in 1999, to subsidize part of the plan's cost, but it could not be determined how much G. M. would contribute. If G. M. agrees to helpfinancethe plan -- something it has not done at this point -- it would be an unusual act of cooperation in a bankruptcy proceeding. It would also be the latest effort by G. M. to ease its former subsidiary's financial burden as it tries to reorganize. Delphi offered this alternative a few days after the company and the UAW reached an agreement on buyout offers to 13, 000 UAW members out of 24, 000 at the parts maker. Under this suggested plan, Delphi has proposed lowering pay for factory workers initially by $5. 50 an hour, to $22 an hour in early July. The rates would later drop to $16. 50 an hour in September 2007. Unless Delphi and its other unions agree, the company has signified plans to ask a federal bankruptcy judge for permission to cancel its labor contracts and impose lower wages and benefits. Such a move would increase the likelihood of a strike by Delphi workers and create more problems for General Motors, Delphi's largest customer. Any strike at Delphi could quickly cripple G. M.’s vehicle production.

Since the 1970s, the automotive industry was characterized by deteriorating conditions like declines in employment and sales. This is the reason why the

Fair Practices in Automotive Products Act (H. R. 5133) has been promoted for consideration by the Congress in 1982. The bill’s “ objective is to restore auto industry jobs by restricting the number of imported cars and parts that enter the U. S. market”.

According to a Special Study of Congressional Budget Office (August 1982), the act would institute minimum " domestic content" requirements for most passenger vehicles and light trucks sold in the United States beginning with model year 1983. The domestic content requirements calculated as U. S. value added as a percentage of the wholesale price—would have to be met by each domestic and foreign auto manufacturer producing more than 100, 000 units for sale in the U. S. market. These requirements would be graduated according to the volume of vehicles sold by each manufacturer. However, the report found that H. R. 5133 would adversely affect the performance of the U. S. economy for a number of reasons. The implied restrictions on auto imports invite retaliatory trade measures on the part of the United States' trading partners, a response sanctioned by the articles of the General Agreement on Tariffs and Trade (GATT).

As this bill was introduced in the House the previous December by Richard Ottinger of New York, it was merely intended both to curb car and auto parts imports and to encourage foreign companies to produce automobiles in this country. The bill would have prescribed the share of parts that had to be produced in the United States and Canada for automobiles, light trucks, and spares. Such measures would raise domestic auto prices and with them, the overall rate of inflation; and they would depress our long-run economic

growth potential by misallocating scarce economic resources. Even if foreign trade retaliation was not extensive, the domestic content bill represents a poor substitute for conventional macro-economic policies. Thus, the report suggested that a positive employment and economic growth effects resulting from H. R. 5133 could be achieved well, with less cost and fewer risks, by the adoption of somewhat more expansionary U. S. monetary and fiscal policies (Congressional Budget Office, August 1982).

Upon the entrance of the 1990s, the “ globalization” perspective had spread and countries realized that they should promote international production and their products should be distributed among countries. Countries should specialize in the production of those goods and services that they can produce most efficiently. Within this framework, the rise of multinational companies (MNCs) had become an instrument for dispersing the production of goods and services to the most efficient locations around the globe. Viewed this way, foreign direct investments (FDI) by the MNCs increased the overall efficiency of the world economy of many countries.

The automotive industry was at the forefront of FDI. Initially, automotives was mainly the result of high tariff barriers that prevented exportation into the host market. However, because of its visibility, automotive FDI has always triggered strong objections. The investment of Japanese automakers, starting with Honda and then continued by Nissan, Toyota, Mazda, and others prompted an outcry in the United States. Japanese car makers were accused of bringing low-added value jobs to the United States, while

maintaining the production of sophisticated components, such as computer-controlled fuel injection systems at home.

However, if automotive FDI was initially prompted by tariff walls, subsequent investment sought to realize advantages of economies of scale and host country competitive advantage, whether in labor costs, component availability, or proximity to market. As part of this evolution, R&D, finance and other high knowledge functions started to migrate to foreign locations. These FDIs could be controlled through trade agreements. For instance, the United States, Canada, and Mexico make up the North American Free Trade Agreement (NAFTA), which in essence has removed all barriers to trade among these countries and created a huge North American market. According to Hodgetts, Luthans & Doh (2005), a number of economic developments have occurred because of NAFTA, and all are designed to promote commerce in the region. They suggested that some the more important developments that NAFTA had advanced include (1) the elimination of tariffs as well as import and export quotas; (2) the opening of government procurement markets to companies in the other two nations; (3) an increase in the opportunity to make investments in each other's country; (4) an increase in the ease of travel between countries; and (5) the removal of restrictions on agricultural products, auto parts, and energy goods. Many of these provisions will take place gradually. Agreements like the NAFTA include supplemental commitments on labor and theenvironmentto encourage countries to upgrade their working conditions and environmental protections, although some critics believe the agreements do not go far enough in ensuring worker rights and environmental standards.

According to Scott (2001, April), the U. S. has experienced steadily growing global trade deficits for nearly three decades, and these deficits have accelerated rapidly since NAFTA took effect on January 1, 1994. As NAFTA supporters have frequently touted the benefits of exports while remaining silent on the impacts of rapid import growth, Scott (2001) countered that any evaluation of the impact of trade on the domestic economy must include both imports and exports. Scott (2006) reasoned that this is why NAFTA has resulted to numerous job losses, aside from contributing to the growing income inequality and to the declining wages of U. S. production workers, who make up about 70% of the workforce

In this survey, it could be deemed that the automotive industry is directly affected by economic factors like inflation, buyer-seller relationships, labor costs, legal restrictions and globalization. In foreseeing its future, several trends in automotive manufacturing are setting the stage for advancements intechnology, as the industry responds to demands for safer vehicles and environmentally safe vehicles.

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