Can the auto industry be saved?

by B. Andrei Sulzenko

Twenty years ago the Canadian automotive sector was at a crossroads. Production had stagnated, and despite high tariffs import penetration was increasing. The Canadian government responded to this deteriorating situation with a series of trade initiatives which culminated in the negotiation with the United States of the Automotive Products Trade Agreement, commonly known as the Autopact. The Autopact fostered unprecedented growth in output and employment in the Canadian auto sector by promoting the rationalization of vehicle and parts production between the US and Canada.

The Canadian auto sector finds itself at a crossroads once more. As in the early sixties, production has declined and imports are taking an increasing share of the market. But there the comparison ends. The automotive world of the eighties and nineties will be remarkably different from that of the sixties and seventies. The pie will be shrinking rather than growing, and in this new environment tradeoffs multiply and no one dramatic policy response, such as the Autopact was in its day, can satisfy everyone's requirements.

Changing world industry

The world recession has accelerated the trend toward the saturation of the auto market in industrialized countries. The outlook for demand in North America, Europe and Japan through the eighties is generally flat, and developing countries are not likely to pick up the slack for some time; and when they do, import replacement policies will ensure a major element of local production. This no-growth environment has increased competition worldwide for market share. To date, the battleground has been largely North America and Europe as the Japanese market is still basically closed to foreign vehicles, notwithstanding the absence of significant tariffs.

In the mass market the strategy followed by automotive manufacturers has been relentless cost-cutting, coupled with quality improvement. The Japanese manufacturers have been in the forefront of this international trend and have essentially caught North America, and to a lesser extent Europe, flat-footed by a combination of superior planning and luck. The planning and managerial capabilities of Japanese companies is now legendary and well documented. Their automotive competitors were perhaps a little slow to realize the need to reduce costs and improve quality, but foresaw, at least in North America, a gradual rather than sudden transformation of the marketplace.

Japanese planning and luck

The multiple shocks of the second oil crisis, financial capacities strained by massive retooling to meet government standards, and a severe and deep recession sent North American companies reeling into disarray and allowed the Japanese, who were in the right place at the right time, to make major inroads into the market. To be more precise, the element of luck for Japanese auto makers was that their substantial headstart down the cost curve coincided with a dramatic shift in the marketplace to demand for smaller, more fuel-efficient and more cost-effective or higher value-per-dollar vehicles. The irony of the present situation is that restraints on the number of Japanese vehicles exported to North America provided an incentive to Japanese manufacturers to shift upmarket to larger, more luxurious, higher value products which compete directly with the products of traditional strength for North American manufacturers.

These events have meant that the major protective barrier for North America — insulation from the world market through product differentiation — has been severely eroded and will over time cease to be a factor. Therefore, as the eighties and nineties unfold, the world market will become more homogenous, i.e., North America will become more like the rest of the world.

Homogeneity will also increase by virtue of greater cooperation among the major manufacturers through joint development, production and marketing ventures. Joint venturing has been taking place for a number of years as a means of reducing not only costs, but risk. In the evolving environment growth can be achieved largely through an increased share of a stagnant market. Therefore, risk becomes much higher than under an expanding market. The costs of developing a new vehicle are now in the billions of dollars, and companies are spreading risk through joint projects. From a corporate point of view this makes eminent sense. But it does not necessarily coincide with the longer term objectives of national governments. It means that automakers will be less identified with host countries than in the past. General Motors may assemble in Spain a Japanese-designed vehicle, with a Brazilian engine, a German transmission, American headlights and Canadian wiper blades, for importation into the North American market. This may be the most cost-effective and profitable solution for General Motors but it does not offer North American industry much value-added. What is best for General Motors is no longer (if it ever was) what is best for America. Canada is, of course, one step further removed from this situation since there was never any guarantee that

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