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# AMERICAN COMPASS

## CASE STUDY

# The Import Quota That Remade the Auto Industry

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## EXECUTIVE SUMMARY

In 1980, Japanese automakers were trouncing Detroit's "Big Three" in the American car market. After decades of intensive state support, Japanese firms had developed the world's most efficient production processes and made the highest-quality cars. Without the time and resources to retool, American automakers risked bankruptcy and mass layoffs. President Ronald Reagan negotiated a quota on Japanese imports that stemmed competition for four years, bought Detroit time to retool, and spurred massive foreign investment in a new manufacturing base in the South that created hundreds of thousands of American jobs.

## KEY LESSONS

**International economic competition defies free-market dogma.** According to market fundamentalists, free markets are supposed to create incentives and competitive pressures that spur productivity and innovation. Active efforts by policymakers are supposed to backfire.

The Japanese auto industry, insulated from foreign competition and subsidized by the state, was not a catastrophic failure, but a global leader in quality and innovation. America's open market did not foster more resilient, productive, or innovative firms; it exposed them to near-fatal import competition. Only when American policymakers stepped in did the domestic manufacturing base improve and grow.

**Bounded markets channel investment and competition in the national interest.** Blunt constraints that set market boundaries, while encouraging competition therein, help to ensure that capitalism's power is serving the national interest. Rather than fostering sclerosis and cronyism, the import quota encouraged innovation, spurred investment, and boosted long-term production.

*Trade barriers create new incentives for investment.* Cars made in America were exempt from the import quota, which led Japanese automakers to invest in U.S.-based assembly facilities.

*Production is a function of past policy and investment choices.* Once assembly moved onshore, Japanese firms had incentives to onshore the rest of their value chain—production, research, and design—and they've chosen to continue their American investments long after the import quota was lifted.

## KEY FACTS

<b>\$25+</b>	<b>BILLION</b>	in foreign capital investment ( <i>2022 dollars</i> )
<b>8</b>	<b>new auto assembly plants</b>	
<b>300+</b>	<b>new production facilities</b>	
<b>100K+</b>	<b>new American jobs</b>	

Today, Honda and Toyota have among the **highest domestic content** of cars sold in America.

## BACKGROUND

After four decades of aggressive public support from its Ministry of International Trade and Industry (MITI)—direct subsidies, tax breaks, cheap loans, and information-sharing—Japan had built an automotive juggernaut by the 1970s with the world’s most efficient production processes and its highest-quality cars.<sup>1</sup> Its top automaker, Toyota, had perfected its management of material to the point that its inventory costs were only a tenth of General Motors’.<sup>2</sup> American automotive engineers awarded many more top product-quality honors to Japanese automakers than to American ones.<sup>3</sup> Over the decade, the Japanese industry improved its productivity at 4.3% annually—three times the American rate of progress.

Whereas American firms competed in a free and open market, Japan had insulated its automakers from foreign competition. On top of the aggressive government support it provided to its own producers, high tariffs kept imports uncompetitive, while onerous standards made it virtually impossible for foreign firms to build operations in Japan.<sup>4</sup> American tolerance for such an imbalanced arrangement was a feature of Cold War-era trade policy and had long been a source of frustration for American auto executives.<sup>5</sup>

From 1970 to 1976, Japanese cars tripled their sales volume in the United States to more than 1 million units and 8% market share.<sup>6</sup> Then came the decade’s second oil crisis. In the wake of the Iranian Revolution in Spring 1979, as oil prices more than doubled, American consumers lost their taste for American-made “gas guzzlers” and switched en masse to smaller, more fuel-efficient cars.<sup>7</sup> In 1980, nearly two out of every three new automobiles sold were small or compact cars, up from fewer than half in 1978.<sup>8</sup>

Small, fuel-efficient cars were a Japanese specialty and the American automakers, unable to quickly retool, quickly lost ground. Japanese automakers reached 21% market share in 1980,<sup>9</sup> at which point they were exporting nearly two million cars annually to the U.S.—more than they were selling in their home market.<sup>10</sup> That year, the Big Three American automakers suffered a \$6.2 billion loss,<sup>11</sup> after an average of \$4.4 billion in annual profits during the previous decade.<sup>12</sup> In the span of two years, Big Three sales had plummeted 30%, to their lowest level since 1961.<sup>13</sup> Chrysler was on the verge of bankruptcy,<sup>14</sup> and over 100,000 auto factory workers had been laid off.<sup>15</sup>

## POLICY INTERVENTION

Backed by the threat of an outright import quota, President Reagan negotiated a “voluntary export restraint” (VER) with Japan’s Ministry of International Trade and Industry (MITI). Japan agreed to limit its auto exports to the United States to 1.68 million, the level from 1979, for three years beginning in 1981. It was the economic equivalent of an import quota.

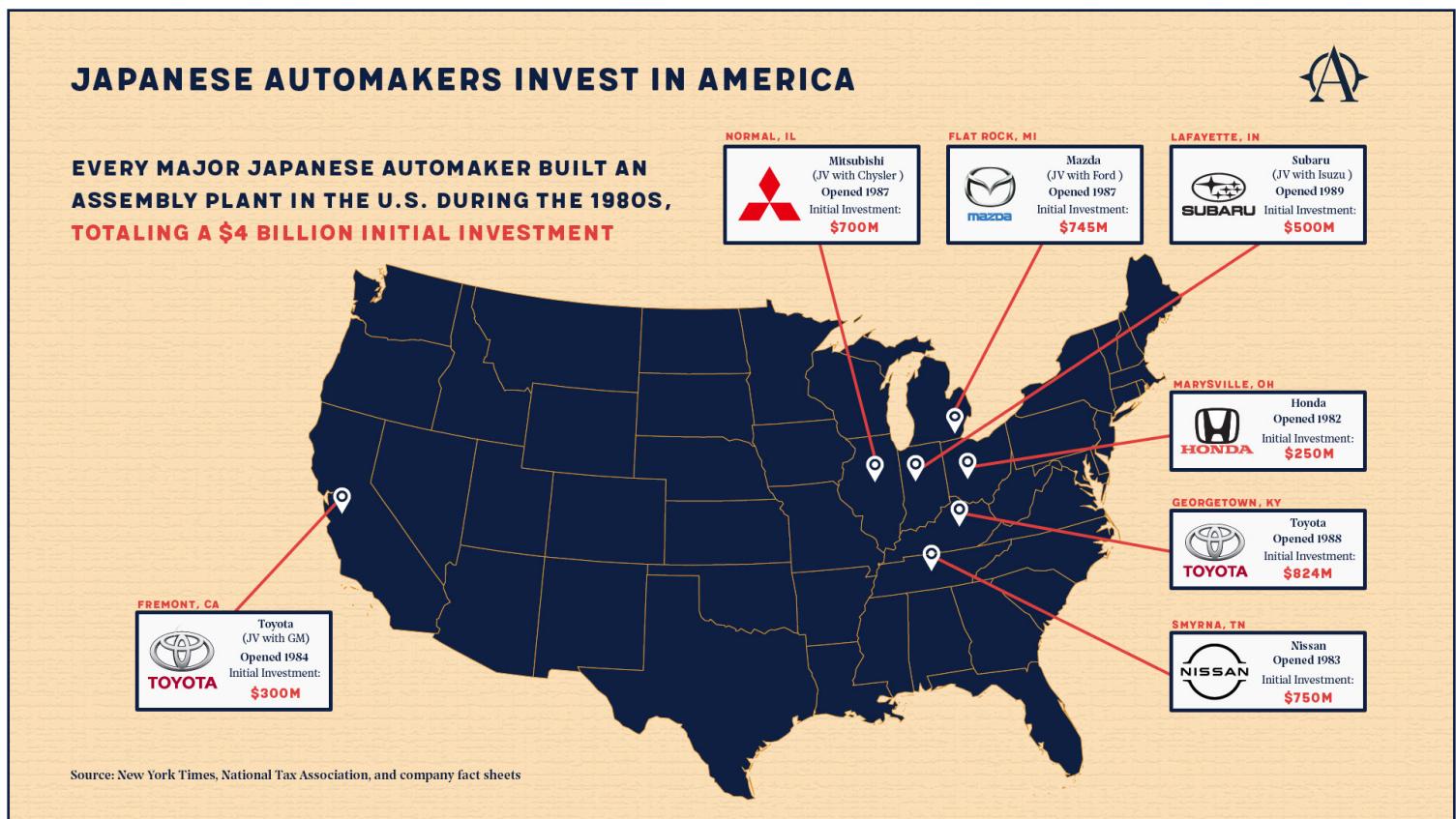
## IMPACT

In the near term, the quota reduced the sales of Japanese cars by 20%<sup>16</sup> and raised prices for consumers by an average of 8%, costing American consumers an additional \$5.1 billion.<sup>17</sup> But within the decade it had prompted nearly three times that much in foreign direct investment<sup>18</sup> and brought 26,600 new auto-assembly jobs to the American South and Midwest.<sup>19</sup> The investment in assembly plants spurred Japanese automakers to onshore more of their value

chains, including component manufacturing and materials, which created 101,700 American jobs by 1991.<sup>20</sup>

### ***Trade barriers created new market incentives to invest.***

The quota set no limit on the number of vehicles Japanese automakers could sell in America, only on how many they could export to the country. Cars built in the U.S. were exempt. As a result, the Japanese automakers had new incentives to invest in U.S.-based manufacturing capacity. In 1980, there were no Japanese auto assembly plants in the U.S. Within a decade of Reagan's action, every major Japanese automaker—Toyota, Honda, Nissan, Mazda, Mitsubishi, Isuzu, and Subaru—began assembling cars in America.<sup>21</sup>



### ***Reduced imports encouraged innovation and competitiveness.***

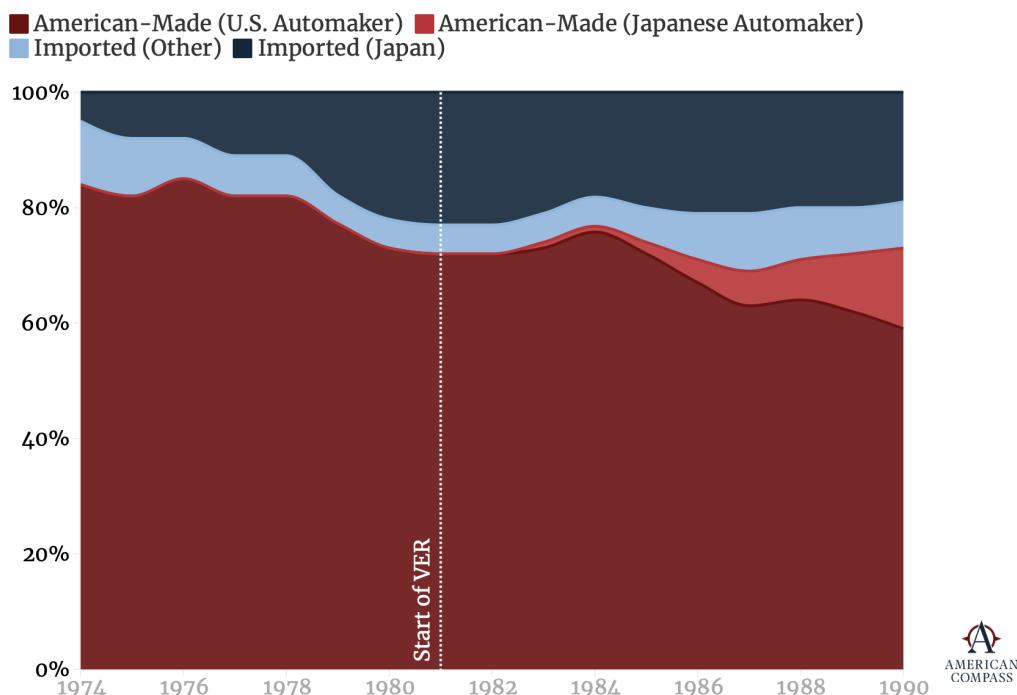
Meanwhile, American automakers took advantage of the breathing room afforded by reduced import competition. They improved their capabilities to compete in the newly fuel-conscious consumer market. Car size and weight declined, while fuel efficiency increased. Operations improved to better control quality while also cutting costs.<sup>22</sup> By 1989, American automakers could produce cars with 25% less labor than in 1979, which equated to robust 3% annual productivity growth.<sup>23</sup>

**New production better served American workers and the national interest.**

Because of the quota, Japanese competition no longer posed the threat to American workers that Japanese imports once did. Once assembly moved onshore, Japanese automakers employed American workers and began to onshore the rest of their value chain, including parts production, research, and design. Many Japanese cars became American-made cars, and the share of American-made cars sold in the U.S. held steady.<sup>24</sup>

**FIGURE 1. VER Stabilized the Share of American-Made Cars Sold in the U.S.—Even as Japanese Firms Sold More**

*Share of the U.S. auto market*



Long after the quota had lifted, Japanese automakers continued to invest in the United States, building production and research facilities in more than 28 states.<sup>25</sup> Today, Toyotas and Hondas are not only assembled in America, but also consistently rank among the cars with the highest American content.<sup>26</sup>

## ENDNOTES

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