CONFERENCE ON TRANSITIONS: THE STATE OF THE AUTO INDUSTRY FEDERAL RESERVE BANK OF CHICAGO

Chicago, Illinois
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Welcoming Remarks

It is my pleasure to welcome each of you the Chicago Fed today, and I'd like to thank you for joining us today for our conference on the state of the auto industry.

We are especially attentive to the issues facing the industry, because, as you look around the U.S. you won't find any other region that is more tied to the auto industry than our own. In the states of the Seventh District—Illinois, Indiana, Iowa, Michigan, and Wisconsin—3 percent of workers are directly employed in the motor vehicle and equipment industry, compared to only 1½ percent for the nation. In Michigan and Indiana, the industry's impact is even greater. Moreover, states in the Seventh Federal Reserve District produce more than 40 percent of U.S. motor vehicle and equipment output with only 13 percent of the country's population.

So for the region, like the auto industry, this has been a time of transition. A decade ago, the state of the Detroit-based automakers was relatively strong. The Big Three had hit a sweet spot in the market. They put themselves at the forefront in developing SUVs and other light trucks, and helped by a period of inexpensive fuel, shoppers could not get enough of them. The strong sales of light trucks helped the Big Three reverse years of market share decline, and by 1996 the Big Three market share had rebounded to just under 75 percent.

However, the Big Three's resurgence proved fleeting. Foreign nameplates developed their own SUVs and pick-up trucks to combat the domestics' large market share. As a result, the Big Three's market share has fallen to 53 percent so far this year. Last year, Toyota passed Chrysler in sales, to become the third highest selling automaker in the US. This development led The Automotive News to rechristen the Big Three as the Detroit Three.

The market share woes of the US automakers have extended to their suppliers. The suppliers are facing shrinking demand at the same time that other developments have squeezed their business. Materials costs have risen sharply, and suppliers' profits have suffered because they have been unable to offset cost increases with productivity enhancements or pass them through as higher prices to their customers. And assembly companies have asked their primary suppliers to share responsibilities such as product design and engineering, which is a significant change in their relationship. But some assemblers and suppliers are finding it difficult to achieve the cooperative relationships now required to produce popular, high-quality vehicles on a mutually profitable basis.

As a result, bankruptcy has become a reality for some of the largest and best known auto suppliers, including Delphi, Dana, Tower, and Collins & Aikman. More than 20 of the largest 150 have filed for Chapter 11 since 1999.

Another significant change relates to vehicle production in the US. Foreign automakers' have increased their operations inside the U.S. Only 21 years ago, Honda Motor Company opened its first U.S. car assembly plant in Marysville, Ohio. Now, foreign nameplates produced in the U.S., often called transplants or the new domestics, account for one-third of U.S. vehicle manufacturing capacity.

The rise of the new domestics has gradually been changing the geography of the industry. Foreign nameplates' domestic production capacity has been slowly expanding the auto corridor into Southern states. Honda opened its first U.S. assembly plant near the heart of the traditional auto corridor. But, more recently, they opened a plant in Alabama, Nissan opened one in Mississippi, and Toyota just opened a truck plant in Texas.

By extending the corridor further south and west, the newly built assembly plants are shifting the industry's center of gravity further south. This shift could pose a challenge to the continued role of the Midwest as the hub of this industry

Developments outside the US are also changing the industry. Though some foreign automakers are producing in the US, imports continue to flow into the market. Imported vehicles accounted for 23 percent of sales so far this year, up from 12 percent in 1996. Imports of parts have increased even more dramatically: direct imports of motor vehicle parts have more than doubled since 1995.

Global forces are also changing vehicle demand. Developing markets such as India and China represent significant opportunities for automakers to increase sales.

The big question is, of course: Where will all this change take us? And that's why we're having this conference—to help us understand the forces behind the changes in the auto industry, which in turn should give us some idea where the industry is heading.

In organizing this conference we wanted to take a different tack from the typical auto conference. One thing you'll notice about the agenda is that none of the speakers is from the auto industry. Furthermore, we've organized the sessions around specific issues facing the industry—issues which will profoundly shape the industry in the near future.

The first session today will look at a broad question: What value is the profitability of the industry? Frits Pil from the University of Pittsburgh will present his work on the topic.