

Declassified in Part - Sanitized Copy Approved for Release 2012/02/02 : CIA-RDP89T00295R000400410001-1

Page Denied

Next 1 Page(s) In Document Denied



**Directorate of
Intelligence**

~~Confidential~~



25X1

RECORD COPY
Return to PPG/R&DB
Paragraphs classified by:

(Signature)

Prospects for Western Europe's Automobile Industry



25X1

An Intelligence Assessment

~~Confidential~~

EUR 86-10044
November 1986

Copy **362**

Page Denied



**Directorate of
Intelligence**

Confidential





25X1

Prospects for Western Europe's Automobile Industry



25X1

An Intelligence Assessment

This paper was prepared by  the
Office of European Analysis. Comments and queries
are welcome and may be directed to the Chief,
Issues and Applications Division, 



25X1

25X1

25X1

Reverse Blank

Confidential

EUR 86-10044

November 1986

Confidential



25X1

**Prospects for Western Europe's
Automobile Industry**



25X1

Scope Note

This paper is the latest in a series examining traditional industries in Western Europe. Two previous papers focused on the shipbuilding and textile industries, and a future assessment will deal with the steel industry. In each paper we focus on the industry's restructuring efforts, foreign competition, and how the role of government has influenced the economic health of the industry.

Our analysis of the automobile industry concentrates on the six major volume-producers in Western Europe—Fiat, Volkswagen, Renault, and Peugeot, along with Ford and GM of Europe. Together these six firms control roughly two-thirds of the total West European market, but close to 90 percent at the low end of the market. Several other firms compete in the volume end of their domestic markets but are not volume suppliers in foreign markets. Daimler-Benz, for example, while having a relatively substantial share of its domestic market has a very minute share of foreign markets because of its specialization in high-priced luxury models. As a result, we are excluding these firms from our definition of major volume producers.



25X1

Confidential



25X1

Prospects for Western Europe's Automobile Industry



25X1

Key Judgments

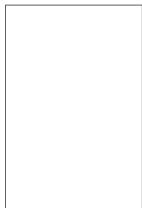
Information available as of 5 October 1986 was used in this report.



After six consecutive years of aggregate losses, the medium-term prospects for Western Europe's automobile industry—the largest industrial sector in Western Europe—remain tenuous, even though the outlook for 1987 is relatively brighter. Total losses for the six major automobile producers—Fiat, Volkswagen, Renault, Peugeot, and Ford and GM of Europe—have been decreasing and four of them turned a profit in 1985. The industry's moderately improved performance results from a combination of restructuring efforts and the general improvement in economic conditions in Western Europe. With consumer confidence boosted by lower interest rates, low oil prices, and planned tax cuts in some countries, we expect performance in 1986 to match 1985's.

25X1

25X1



Several major structural problems remain, however, with overmanning and excess capacity continuing to be the primary ones. These problems, combined with an intensely competitive market, will work to keep profit margins depressed for the next several years. West European firms are trying to come to grips with the problems, albeit with varying degrees of success. In addition to trying to shed more workers, the industry is looking at joint ventures to improve productivity and competitiveness. Fiat and Volkswagen have been the industry leaders in modernizing operations, but even they still face a serious competitiveness problem outside their home markets. Renault, which has been the slowest among the six to restructure operations, has correspondingly more serious competitive problems. On the other hand, we believe Ford and GM of Europe may be in a position to increase their market shares because both firms' operations now include three home markets—West Germany, Britain, and Spain. The latter is especially important because of its low labor costs and newly gained duty-free access to EC markets as a Community member. Achieving their goals, however, is proving difficult. Ford has yet to merge with another West European firm in its attempt to lower development costs, while GM must improve its production efficiency and may have to abandon its price discounting strategy to cut losses.

25X1

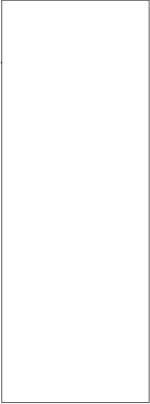
25X1


West European automakers are also increasingly relying on automation to cut production cost and achieve greater flexibility. New production technologies alone, however, will not enable the West Europeans to equal Japanese efficiency. The leading West European automakers employ technology similar to that of the Japanese. Much of Japan's success is attributable to lower labor costs along with its more efficient workforce

Confidential



25X1



and management techniques. West European automakers will have to concentrate in these areas if they are to close the gap with their Japanese counterparts. 

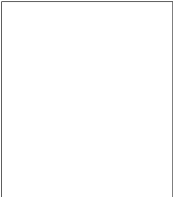
25X1

25X1

We believe that the restructuring process will remain on a slow track over the next two years because of union resistance and the reluctance of associated socialist parties to back programs that could cost jobs and hurt them in elections. In addition, most West European governments are growing more reluctant to subsidize the industry directly. But, too many jobs are at stake for them to stop protecting the industry altogether, and we believe governments will increasingly rely on trade restrictions and local content legislation to shelter the industry against third-country imports.



25X1



Even if the West Europeans should make marginal improvements in their efficiency, as we expect, we believe the Japanese will be moving ahead faster, pushed in part by the new competitive threat also facing West European producers—South Korea. The South Koreans are also attempting to become a major automobile exporter, and, given their success in the steel and shipbuilding industries, we expect the Japanese to respond and make every effort to maintain their current market advantage. Consequently, the West Europeans are unlikely to match Japanese efficiency even in the medium term. Restructuring efforts have not enabled the West Europeans to recapture lost shares of third markets, and prospects—particularly in the low-priced, high-volume end of the business—are dim. Growing South Korean competition will further squeeze the West Europeans out of third markets as well as create new challenges for the volume producers in their domestic markets. Western Europe's competitive advantage, both at home and abroad, is likely to continue at the top-end, luxury class of automobiles, a market the Japanese are only beginning to target.



25X1

25X1

Confidential

Contents

	<i>Page</i>
Scope Note	iii
Key Judgments	v
Introduction	1
Present Situation	1
Automaker Problems	4
Labor Demands	4
Government "Help"	5
Japanese Competition	6
Capacity and Investment	7
The Road Back to Profitability	8
Outlook	10

Confidential

25X1

Prospects for Western Europe's Automobile Industry

25X1

Introduction

The automobile industry is both Western Europe's single-largest industrial sector and employer, and is one of several traditional industries undergoing major restructuring. Unlike the cases of the steel and ship-building industries, however, governments are trying to minimize their future involvement with the automobile industry. Despite recent improvement, the industry still accounts for about half the world's excess production capacity and must make further cuts in plant size and number of workers if it is to improve competitiveness in the long run. We will examine the progress the volume producers have made in restructuring their operations and assess their prospects for overcoming the obstacles and constraints still facing them.

1980's (see figure 2). Prospects for automakers appear good for 1986 and 1987 if, as we expect, West European economies continue their upturn:

- Consumer demand should remain firm as real personal income continues to rise. Decelerating inflation, aided by the decline in the dollar, should work to drive down interest rates, helping sales of consumer durables and autos in particular.
- Generally weak raw-material prices should continue to help producers hold down costs, while low oil prices benefit both producers and consumers.
- Income tax cuts in some countries—such as West Germany and Belgium—will help boost consumer confidence and spending.
- European automakers should benefit from the appreciation of the Japanese yen, which has raised the price of Japanese cars in Western Europe, although not as much as in the United States.

25X1

25X1

25X1

25X1

Present Situation

The West European auto market is fragmented and highly competitive (see figure 1). Only 2.2 percentage points separated first place from last among the volume producers in 1985, down from a gap of six percentage points in 1980. Because the market is so intensely competitive, efforts to increase efficiency by expanding volume have generally set off scrambles for larger market shares. The result has usually been widespread price cutting—with discounts ranging between \$200 and \$2,000 on models—which hurts earnings. Cutting profit margins in Western Europe has been particularly damaging because the market is dominated by small economy models for which profit margins are already tight.

Although business-cycle conditions have benefited most automakers, some volume producers have returned to profitability largely because of restructuring efforts to reduce cost and improve efficiency. Those firms that have gone furthest in automating, trimming labor forces, and reducing break-even points are now profitable at much lower output levels than at the start of the 1980's. Among the volume producers, Fiat and Volkswagen have been the most aggressive in restructuring their operations and in regaining profitability.

25X1

25X1

25X1

25X1

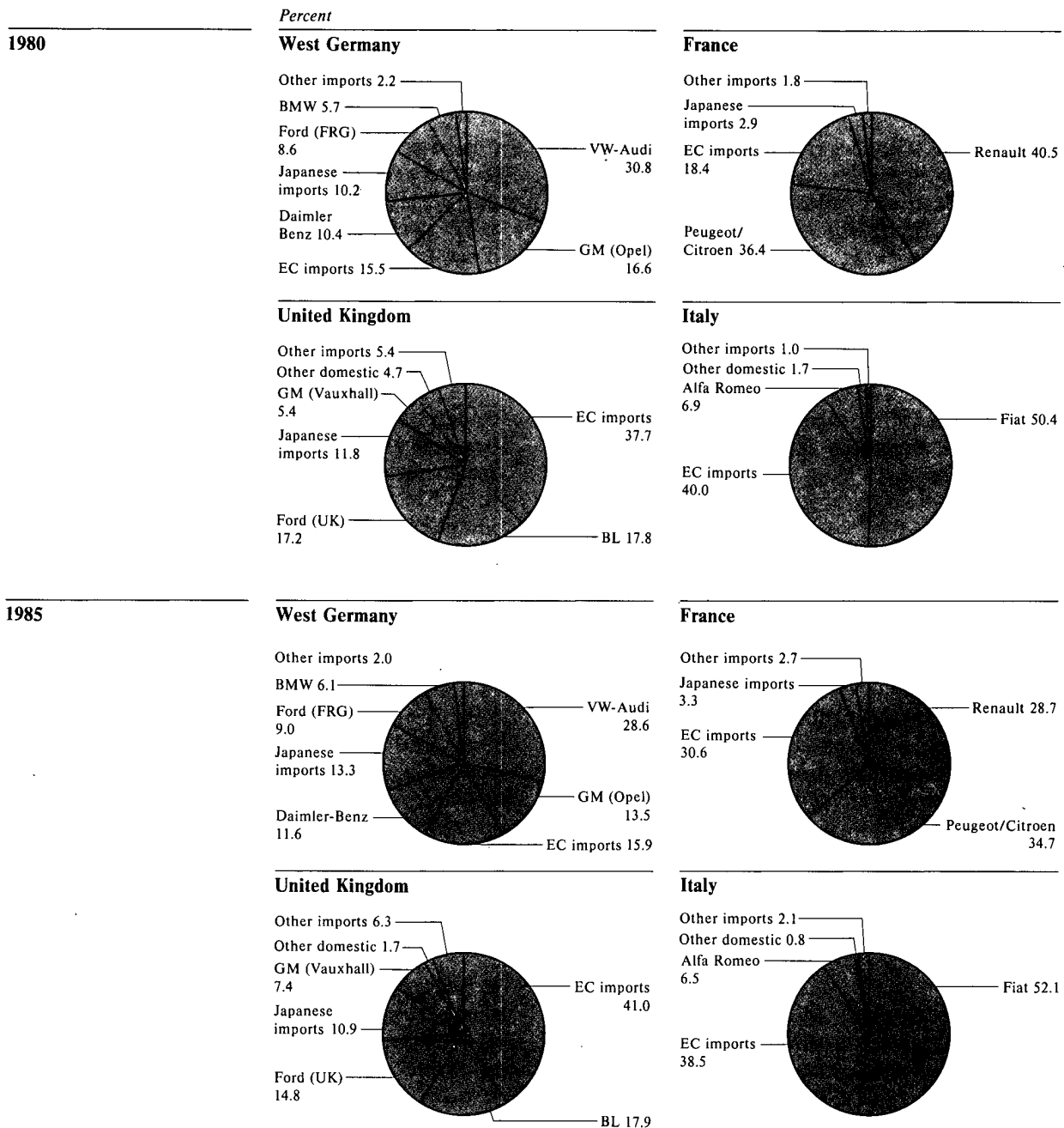
After five consecutive years of losses totaling \$3 billion, aggregate losses for the West European automobile industry are now on the decline. Although the industry in 1985 still lost roughly \$300 million, sales reached 10.6 million units, the highest in the

The major part of Fiat's success is the result of sharp reductions in production costs. Fiat's total work force is down about 30 percent since 1979. The smaller work force helped increase productivity by 70 percent

Confidential

Confidential

Figure 1
West European Automakers: Share of Domestic
Automobile Markets, 1980 and 1985



311071 11-86

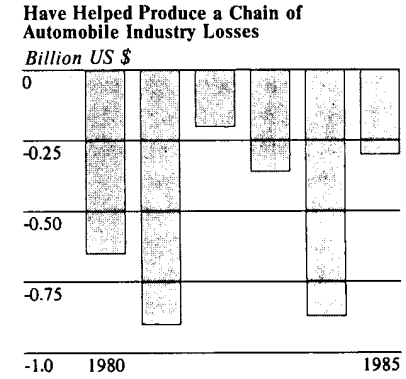
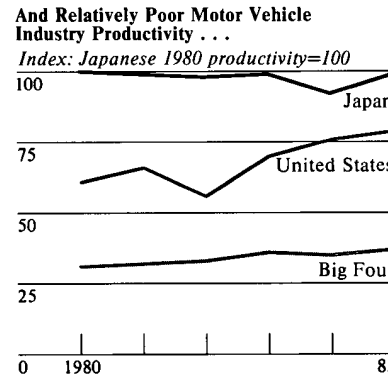
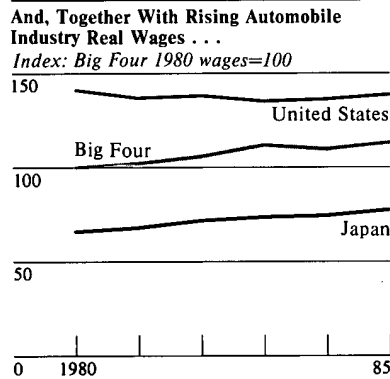
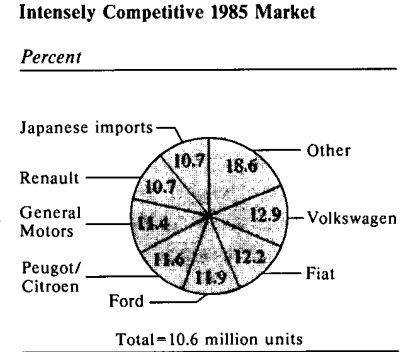
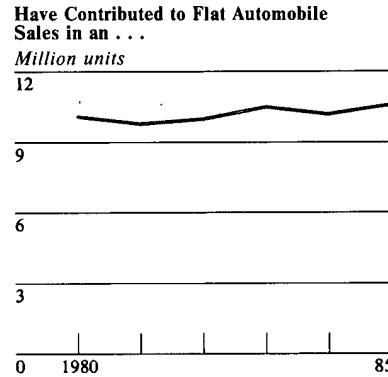
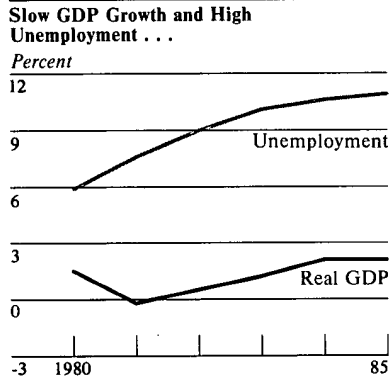
25X1

Confidential

Confidential

Figure 2
Western Europe: Selected Economic Statistics, 1980-85

Note scale change



25X1

25X1

311081 11-86

during the period 1979-83, and by 1985 the automobile division earned \$280 million in profits. Absenteeism—endemic in Italy—dropped from 20 percent in 1980 to just 4 percent by 1983. In addition, Fiat enjoys a highly protected home market that has helped its profit margin. According to industry analysts, higher domestic profits and volume production have allowed Fiat to reduce profit margins on exports, making it more competitive in other West European countries where Fiat officials have decided to concentrate their efforts. Fiat stopped selling in the US

market in 1983, a bold, strategic move that cut losses and simplified their marketing strategy.

Surging exports, on the other hand, enabled Volkswagen to overtake Ford last year and become the market leader in Western Europe. Volkswagen's profit in 1985 was roughly \$200 million, up from \$83 million the previous year. The company's success stems primarily from exports of high-priced Audis to

25X1

Confidential

Confidential

the US market, windfall gains resulting from the strength of the dollar during 1983-85, and the rising European sales of its Golf model—the best selling car in Western Europe in 1985. In contrast, domestic sales increased only 2 percent in 1985 as consumers stayed out of the market, waiting for Bonn to decide whether to require pollution controls on automobiles.

Peugeot also returned to profitability in 1985, earning a \$60 million profit after five years of losses. Most of Peugeot's improved performance results from extensive restructuring and the popularity of its 205 model. Company officials point out that unlike state-owned Renault, their firm's recovery was achieved with comparatively little government support.

In spite of the recent economic upturn and state subsidies, Renault continues to perform poorly. Renault's domestic sales dropped 7 percent in 1985 after plummeting 23 percent in 1984. Its dismal sales record contributed to record losses of \$1.2 billion in 1985 and \$1.4 billion in 1984. In addition to slumping sales, Renault has suffered because it has implemented structural reforms at a much slower pace than its more successful West European competitors. The company plans to trim its labor force from 98,000 to 77,000 by the end of 1986, primarily through voluntary incentives. Its record and certain union resistance suggest that it will fall short of that goal.

The West European affiliates of General Motors and Ford have a mixed record. GM, which owns Opel in West Germany and Vauxhall in Britain, has been pursuing a risky strategy of boosting its market share through aggressive price discounting. It sold a record 1.2 million units in 1985 and increased its share of the West European market to 11.4 percent—up from 8.2 percent in 1981. Its losses also increased, to \$372 million, up from \$291 million the previous year. Ford, on the other hand, has consistently turned a profit throughout the decade. GM is in the process of reorganizing its West European operations to achieve better production coordination and increased efficiency like archrival Ford. Ford, for its part, is seeking to merge with another West European firm to reduce development costs, but it is having trouble. Fiat, which itself negotiated unsuccessfully with Ford

about a merger, wants Rome to reject Ford's offer of an agreement that would give it control of Alfa Romeo.

Automaker Problems

In spite of the current improvement in their fortunes, the major West European auto firms face a wide range of problems that will not be solved easily:

- Overemployment and strong unions are likely to keep firms' unit labor costs relatively higher than in the United States or Japan.
- Government help—subsidies, protectionism, and other generally defensive-type aid—will continue to slow West European firms' adjustment to new market conditions.
- Japanese competition will continue to help keep prices and profits down.
- Excess capacity will continue to keep costs high and to hamper attempts to increase productivity, despite the efforts of automakers to redirect their investment energies.

Many of these problems are reflected in the poor productivity figures of West European automakers. Productivity among the volume producers ranges from 8.5 to 12.0 motor vehicles per man-year, or 40 to 60 percent below that of Japanese firms. Part, but not all, of the Japanese advantage comes from the longer hours their employees work compared with the West Europeans. Japanese autoworkers put in about 2,200 hours per year, or about 25 percent more than their West European counterparts.

Labor Demands

Powerful labor unions and rigid labor laws combine to form a formidable obstacle to further reductions in the labor force, a key to improved productivity. Temporary layoffs are not allowed, and overtime is viewed by most labor unions as a management ploy to hold down employment. Nowhere is the need for change more pressing than in France. In 1984 a government commission concluded that the French automobile industry needed to shed 70,000 of 230,000 jobs and undertake a major investment program to

25X1
25X1

25X1

25X1
25X1

25X1

25X1

25X1

25X1

25X1
25X1

Confidential

Confidential

Table 1
Selected Countries: Real Hourly Earnings
in the Automobile Industry ^a

Million US \$

	1980	1981	1982	1983	1984	1985
United States	15.88	15.41	15.54	15.21	15.34	15.62
Japan	6.93	7.15	7.54	7.74	7.83	8.15
West Germany	15.53	15.90	16.25	16.79	16.73	17.31
France	10.36	10.69	11.24	12.91	11.79	11.70
United Kingdom	8.24	8.05	8.44	8.65	8.84	9.46
Italy	8.08	8.52	8.78	8.75	8.98	9.46
Spain	7.11	7.94	7.95	7.88	7.71	7.87 ^b

^a Deflated hourly earnings converted at 1980 exchange rates.

^b Estimate.

remain competitive. The commission pointed out that French automobile companies employed one-third more workers per unit produced than did Fiat. [redacted]

Yet when Citroen, a subsidiary of Peugeot, proposed in 1984 to reduce its work force of 46,000 to 40,000, angry employees staged a strike and occupied a manufacturing plant. Only after months of negotiations with the government and labor unions did Citroen receive union permission to eliminate some 4,000 jobs through retirements and 2,000 through layoffs. With the exception of West German producers, most European firms have faced similar reactions when layoffs have been proposed. By preventing companies from laying off excess workers, unions have limited the use of labor-saving equipment that otherwise would improve efficiency and lower production costs. [redacted]

Labor unions also make it difficult for West European automakers to reduce wage costs. Although still lower than in the United States, wage rates in Western Europe are generally higher than in Japan. Spanish wage costs are an exception, and consequently Spain is viewed by some automakers as an ideal manufacturing base for auto exports (see table 1). [redacted]

Government "Help"

Government intervention has created problems by enabling firms, which otherwise might have been forced to revamp operations or leave the market, to maintain operations despite heavy losses. Faced with rising unemployment rates, governments often tried to protect or create jobs at times when the industry needed to eliminate them and increase automation. The specific form of intervention has varied, but usually has involved direct and indirect subsidies, and import quotas:

- **Rome** continues to protect the Italian automobile industry by severely restricting Japanese imports. The Japanese can sell only about 2,500 vehicles per year because of an agreement dating back to 1953. Rome also supports the industry by taxing the ownership of cars so that small cars, which have been Fiat's traditional strength, are more attractive to Italian consumers. Low interest loans were made available to state-owned Alfa Romeo to cover losses, restructuring, and R&D programs.

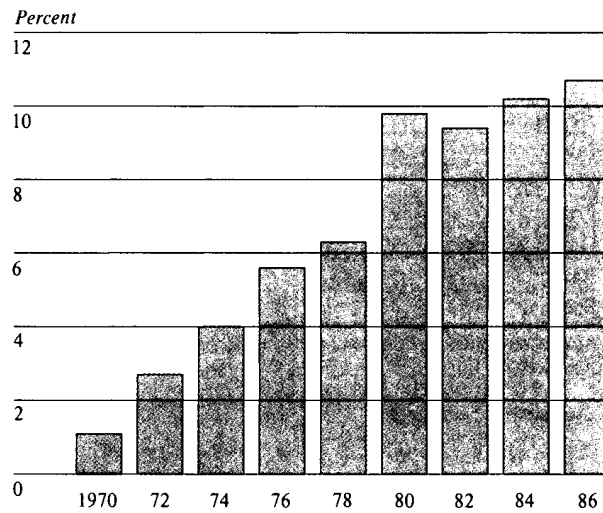
Confidential

Confidential

- **Paris** wants to ensure the survival of at least one, if not two, French firms in the world automobile market, according to press reports. This year state-owned Renault will receive between \$2.8-3.5 billion (at first-half 1986 exchange rates) in grants and low interest loans. In addition to providing financial assistance to state-owned Renault to cover losses and finance modernization, Paris's reluctance to agree to common EC automotive standards is, in effect, a nontariff barrier against imports. Japan's share of France's automobile market has been limited to 3 percent since 1977. The government's restrictions on foreign investment also keep non-EC firms from establishing operations in France.
- **London's** involvement with the automobile industry consists primarily of voluntary restraint agreements (VRAs) with Japan and furnishing subsidies and low interest loans to state-owned British Leyland (BL). Since the late 1970s, Tokyo has agreed to voluntarily limit its share of the British automobile market to 10.6 percent, which not only benefits struggling BL but other UK automakers as well, including Ford and GM. To provide additional support for BL, London has given the firm over \$3 billion since 1975.
- **Bonn** is an exception to the general rule. Its involvement in the industry has been minimal, apart from its role in securing an informal agreement limiting the share of Japanese imports to 10 percent of the West German market during 1981-83. The above-average performance of the West German economy, and the automobile industry in particular, has limited the need for government intervention. Also in West Germany's favor is the generally good relationship between labor and management. Union involvement in the managerial decision making process has generally created a more positive attitude by workers toward technical change.

West European governments now are tending to back away from direct support of the automobile industry in favor of more indirect methods. In early 1986, for example, Madrid sold a 51 percent interest in SEAT, its state-owned automaker and perennial lossmaker, to Volkswagen rather than continue providing massive subsidies. London is also adopting a harder line

Figure 3
Japan: Share of West European Automobile Market, Selected Years



311082 11-86

against subsidies for state-owned BL. Although governments may no longer be willing to provide the automobile industry with generous subsidies, too many jobs—roughly 5 million—are at stake for them to completely abandon the industry. Governments are relying more on trade restrictions and are looking at local content legislation as means of aiding the industry.

Japanese Competition

The Japanese have an overall market share of 11 percent of the West European automobile market, up from only 1 percent in 1970 (see figure 3). The Japanese share certainly would be higher if not for import restrictions, particularly in France and Italy. In Belgium, Denmark, Ireland, and the Netherlands—all countries with few or no import restrictions—the Japanese market share ranges from 23 to

Confidential

Confidential

25X1

[Redacted]

34 percent. Japanese producers, at least when the dollar was stronger, have been willing to accept smaller profits in Western Europe in exchange for market share. [Redacted]

increase over 1982 resulting from improved sales by Mercedes and other luxury auto manufacturers. Because of the Japanese competition, however, the volume producers were unable to take full advantage of the dollar's strength during 1981-85 and continued to lose market share in the United States. [Redacted]

press

25X1

25X1

There is no single reason for Japan's competitive superiority. A good part of its success can be attributed to the labor cost and quality advantage it holds over its main competitors, but these are not the only reasons. Neither is automation the reason—the Japanese employ the same level of factory automation in production operations as the leading West European producers. Much of Japan's advantage stems from its more efficient work force and management techniques:

Western Europe also has lost market share because several LDCs have established their own automobile production facilities and are both competing for export sales and closing off their own domestic markets to European producers. As more newly industrializing countries begin developing their own automobile industries, West European automakers are likely to be squeezed out of additional markets. For example, South Korea, following its success in electronics, steel, and shipbuilding, is determined to become a major automobile exporter. Other LDCs, such as Taiwan, India, and Malaysia, are increasing their production of automobiles and are relying on domestic markets for sales. These countries are adopting high tariffs and stringent local content laws on auto imports, as well as tying automobile imports to exports of other products. The decline in Western Europe's shipments to Africa and Latin America already amounts to almost 37 percent since 1980, compared with only 25 percent for Japan. [Redacted]

25X1

25X1

25X1

25X1

[Redacted]

- Die changes in a Japanese plant can be made in five minutes, contrasted with four to six hours in most West European plants.
- Japanese plants typically have only four to eight hours of inventory on hand, compared with about 20 days for some West European producers.
- The Japanese approach to quality control in manufacturing and design, which is based on defect prevention rather than detection. [Redacted]

Japanese competition has affected West European exports as well. From 1975 to 1981, Western Europe's share of auto exports from members of the Organization for Economic Cooperation and Development, excluding intra-West European trade, dropped from 36 percent to 27 percent, while the Japanese share rose from 29 percent to 57 percent. Nowhere has the decline in Western Europe's share of foreign markets been more evident than in the United States. Unlike small West European automakers with special niches in the US market, such as Mercedes, Saab, and BMW, the volume producers have been beaten out in the US market by the Japanese and no longer ship a high percentage of their exports to the United States. In 1975, Western Europe sold nearly 672,000 cars in the US market compared with just over 867,000 by Japan. By 1982, however, Japanese sales had more than doubled to roughly 2 million units while West European sales slipped 35 percent to about 436,000. In 1985 the West Europeans edged their shipments up, to 606,000 cars, with nearly 77 percent of the

Capacity and Investment

25X1

Chronic overcapacity is a major problem plaguing the volume producers. Industry experts believe West European production capacity must be cut 20 percent, by 2.2 million units, to bring supply in line with demand and restore profitability for all the volume producers. Not all producers, however, accept this logic. Peugeot, for example, is seeking to boost its capacity from 1.85 million units to 2 million units. Peugeot officials want to increase production capacity and flexibility to be able to respond better to changes in market demand. [Redacted]

25X1

Past investment decisions have exacerbated the capacity problem. Before demand slipped in 1981, West European automakers primarily concentrated their

Confidential

New Approaches to Automobile Production

New technologies in the automobile industry fall primarily into three categories: flexible manufacturing systems, industrial robots, and computer-aided design and manufacturing (CAD/CAM) systems. Each of these systems can reduce production costs, but combining all three provides the greatest improvement in efficiency and flexibility. Many of the small, specialty producers are reducing their costs by investing in these systems to improve productivity, lower break-even points, and reduce unit labor costs. All of the volume producers are moving in this direction with Fiat and Volkswagen leading the way.

Flexible manufacturing systems consist of a line of machine tools and transfer machinery that are programmed to produce either several types of components or the same type of component according to different specifications. When applied to the casting and machining of an engine block, for example, such systems permit one transfer line to produce four-or six-cylinder engines where previously two lines had been required.

Industrial robots with artificial limbs and a degree of mobility can be used in welding, painting, and performing other tasks potentially harmful to human

beings. Given the current limitations of robots, work must be brought to them; consequently, it is more efficient to combine robots with flexible manufacturing systems that already have material-handling capability. Robots save costs by improving quality, eliminating the need for inspectors, reducing absenteeism, and working longer hours in poor working conditions. Renault claims that by installing robots it has increased output at its Douai plant by 20 percent.

Computer-aided design (CAD), using minicomputers and sophisticated software packages, increases the speed and efficiency of component design. CAD systems allow designers and engineers to improve the accuracy of measurements, ensuring the uniformity of parts. Designers are tying these systems to computer-aided engineering packages that ease the task of calculating shapes and choosing the best materials for specific functions. Computer-aided manufacturing (CAM) systems transfer coded instructions from the CAD cathode ray terminal to the robots and machine tools needed to fabricate the parts.

25X1

25X1

25X1

investment activities on expansion, model upgrades, and changeovers. Afterwards, when demand fell flat, emphasis shifted toward becoming more efficient and cutting capacity. Mounting losses, however, have slowed the industry's progress and efforts to increase automation also have run into stiff union resistance.

The accelerating product-life cycle, primarily brought about by changes in technology, is increasing the industry's investment and production costs and further intensifying competition. Historically, West European car models have lasted eight to 10 years. To remain competitive, however, West European producers must now restyle product lines more frequently and incorporate new technologies. Consequently, the

time over which each model provides profits has been shortened, but more capital expenditures are required for product development.

A generally inefficient supplier base in Western Europe has slowed the pace of innovation and raised inventory costs. Although inventory policy is changing, West European automakers have typically purchased most parts from medium-sized independent suppliers and have maintained high inventories because of the risk of strikes. In contrast, the close relationship between Japanese automakers and parts suppliers has allowed them to maintain a "just-in-time" inventory policy, keeping stocks and working capital requirements much lower than in West European firms. Also, the lag in investment in Western

25X1

25X1

25X1
25X1

25X1

Europe relative to Japan for the development of state-of-the-art automobile components has probably been caused, in part, by the lack of integration between West European component suppliers and automobile manufacturers. [redacted]

Fiat and Volkswagen are relying on flexible automation to build automobiles with 30 to 50 percent less direct labor than they used at the end of the 1970s. Traditionally, West European automakers had to run off at their various plants about 250,000 copies per year of each body style and about 500,000 copies of each engine and transmission to achieve full economies of scale. With flexible automation, West European automakers may still have to sell at least 250,000 vehicles out of one plant, but one plant will be able to make different models without any production-line interruptions, resulting in significant cost savings. Increased manufacturing flexibility is reducing the heavy investment required for design changes and retooling that previously had required shutting down for several months. [redacted]

25X1

25X1

25X1

25X1

The Road Back to Profitability

West European automakers are experiencing various degrees of success in their efforts to become more competitive. They are now directing most of their investment into robotics, flexible automation, and sophisticated machine tools to improve efficiency and reduce their break-even point (see inset). Fiat and Volkswagen are making the greatest use of automation in Western Europe and are also the ones who have shown the most dramatic turnaround in profitability. Relations among firms are also changing, with joint ventures becoming a popular means of pooling technological and marketing skill, as well as increasing economies of scale at both domestic and international levels. Product collaboration is limited, however, by political and union pressures. [redacted]

In their search for greater economies of scale, West European automakers are increasingly turning toward joint ventures to reduce design and production costs, particularly for engines and transmissions. Fiat, Lancia, and Alfa Romeo of Italy, along with Saab of Sweden, are engaged in a cooperative effort to develop a new range of cars toward the upper end of the product line for each company. Saab's version, the 9000, is the first of the foursome to debut. Saab credits the venture for lowering costs of building prototypes and developing and testing components. Fiat estimates that work was done for about \$50 million among the four that would have cost \$80 million if undertaken separately. [redacted]

25X1

25X1

25X1

25X1

Fiat, which already has about 900 robots in operation today, pioneered their use in 1972. The firm's new Mirafioire plant, near Turin, is at the industry's leading edge, in terms of technology. The cost of Fiat's R&D and modernization during 1984-87 will total nearly \$5.5 billion. Fiat can now break even with production of only 1 million units, compared with 1.5 million in 1980, largely through these efforts. [redacted]

Further product collaboration in Western Europe is limited by interference from politicians and unions, particularly when it involves shifting components across national boundaries. Fiat supplies Saab with only a few dozen stampings for the 9000 and claims it could easily ship more at prices 10 to 15 percent below the cost of the same pieces made in Sweden. Objections by Swedish unions prevent Fiat from contributing more. Peugeot and Fiat collaborated on a new Italian engine plant but Paris insisted that the engine be produced in France as well. Fiat is moving ahead and also plans a three-cylinder derivative while Peugeot, in response to Paris's objections and because of changing priorities, has no immediate plans for the engine. [redacted]

25X1

25X1

25X1

25X1

25X1

Volkswagen also is an industry leader in the use of automation, employing about 1,200 robots now, with 2,000 projected by 1990. Volkswagen spent roughly \$3.4 billion during 1982-83 to modernize its facilities, despite disappointing financial performances both years. The futuristic Wolfsburg plant, which produces the Golf, boasts what company officials believe is one of the world's most modern production facilities. In addition to a fully automated and flexible body-welding line and robotized paint shop—features common to many automobile plants—the Volkswagen facility also uses robots to install engines, brakelines, batteries, and wheels. This system can produce not only the Golf but also the Jetta without a change of tools or a halt in production. [redacted]

Confidential**Outlook**

West European automakers will continue to face stiff competition, low profitability, and excess capacity over the next several years. Price will remain of secondary importance at the upper end of the market, but it will still play an essential role at the lower end, keeping the pressure on the volume producers' profit margins. Furthermore, buyers in the mass market—apart from Italy and France—can easily switch to Japanese imports. As a result, reducing costs will become even more important over the medium term, but that is likely to be difficult to achieve.

without compensatory capacity shedding, the West European automobile industry will increase its capacity by about 1 million units to 14 million by 1990. National pride and political realities, however, make it very unlikely that any of the mass-market producers would be allowed to fail.

Joint ventures involving West European firms are likely to increase but will not necessarily solve all of the industry's problems. Other problems may arise in addition to political and union obstacles. Mergers of equals are unlikely to succeed unless one of the partners is willing to sacrifice its identity; and mergers of two inefficient firms, of course, may not produce a single efficient one. Renault has little to show for its interest in American Motors, and Peugeot nearly crippled itself by buying Chrysler's European operations.

Within the West European market, the subsidiaries of GM and Ford are likely to achieve competitive advantages in the years ahead. Both firms are able to collaborate with their US parents and with their Latin American counterparts to take advantage of the economies of scale these relationships offer. This is likely to promote better decisionmaking, improve product development, and optimal adjustment of plant size. The market shares held by the other major volume producers are highly dependent on home-market performance. In the case of GM and Ford, the existence of more than one "home market"—West Germany, Britain, and now Spain—gives them a good base from which to increase their relative market shares in the near term.

Table 2
Western Europe:
Automobile Density

*Automobiles per
1,000 total population*

	1980	1982	1986 ^a	1990 ^b
West Germany	377	390	431	464
France	356	373	390	414
United Kingdom	276	285	321	341
Italy	311	346	379	405
Netherlands	309	325	340	361
Belgium	321	329	349	367
Denmark	271	265	282	294
Spain	202	221	241	259
Ireland	216	204	218	231
Portugal	95	104	117	126
Greece	91	96	114	120

^a Estimated.

^b Projected.

The continuing drive to restructure the West European automobile industry could be slowed by political considerations. As firms strive to increase productivity and competitiveness over the next two years, more layoffs will be required at a time when the socialists in West Germany, France, and the UK will be vying for a comeback in national elections. Union disturbances are most likely during these election campaigns when the employment issue would draw more attention.

Spain, Greece, Portugal, and Ireland have relatively lower automobile densities than other West European countries, and offer the best growth potential to automakers (see table 2). The Spanish auto market, fifth-largest in Western Europe and more than double the size of the other low-density markets combined, is still immature and protected. As import barriers gradually come down because of EC accession, Spain will become more attractive as an export market. Sales in Spain peaked at 660,000 units in 1977 and only 540,000 units were sold in 1985; DRI projects 575,000 sales in 1986. Exports from Spain also can be

25X1

25X1

25X1

25X1

25X1

25X1

25X1

25X1

25X1

25X1

25X1

Confidential

Confidential

[Redacted]

expected to increase over the next few years. Low Spanish labor cost and the country's entry into the EC in 1986 make it an ideal base for both production and export. [Redacted]

flexible labor market—union demands and hard-to-remove labor laws—and protectionism will continue to be the major impediments to streamlining initiatives. Marginal improvements in competitiveness, however, will not enable the West Europeans to beat back the Japanese, who will continue to mount a stiff challenge. New low-cost competition from South Korea is providing strong incentive for the Japanese to improve their production efficiency. Furthermore, despite their recent improvement, the West Europeans have failed to recapture lost shares of third markets and they are unlikely to do so in the near future. Western Europe's only competitive advantage lies at the top-end, luxury class segment of the market, which the Japanese have just begun to target. [Redacted]

25X1

25X1
25X1

[Redacted]

[Redacted]

Trade restrictions against Japanese imports are likely to remain, leaving little opportunity for Japanese manufacturers to increase direct imports substantially beyond their current 11-percent market share. Mounting trade frictions with the EC prompted Japan's Ministry of Trade and Industry (MITI) voluntarily to limit the increase in exports of vehicles to the EC to no more than 10 percent over the 1985 level of 1.1 million cars. Japanese automakers, however, probably will continue circumventing restrictions by expanding plant operations in Western Europe: Nissan already has a site in Britain, Honda is considering expanding its assembly operation with Austin Rover, and Toyota is looking into setting up its own operations in Western Europe. The Japanese are likely to use their West European plants to concentrate on producing low-priced automobiles while boosting their exports of high-profit models. [Redacted]

25X1

25X1

[Redacted]

Japanese expansion in Western Europe is likely to exacerbate EC-Japanese trade relations. The Community has often criticized Tokyo for barriers preventing the penetration of Japanese markets. If, as we expect, the Japanese continue to increase their share of the West European automobile market—even if accomplished by direct investment—it is likely to fuel resentment and protectionist sentiments against Japanese automobiles, and almost certainly other Japanese imports, including consumer electronics, machine tools, and semiconductors. [Redacted]

25X1

25X1

25X1

The challenges still facing the West European automobile industry indicate that the volume producers will experience an uncertain profitability picture for the medium term and remain highly vulnerable to an economic downturn in the short term. The progress in restructuring so far, while significant, has not brought the European producers close to Japanese production efficiency. And, in the future, automakers will find it even more difficult to achieve additional gains. The amount of investment required for further restructuring will be high, and because of the poor profit outlook, returns will be marginal. Barriers to a more

Confidential

Confidential

Confidential