STATEMENT OF BARRY FELRICE, ASSOCIATE ADMINISTRATOR FOR PLANS AND PROGRAMS, NATIONAL HIGHWAY TRAFFIC SAFETY ADMINISTRATION, DEPARTMENT OF TRANSPORTATION, BEFORE THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS, HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE, JUNE 17, 1980

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before your Subcommittee today to discuss a recent contract entitled "Corporate Strategies of Automotive Manufacturers" which was prepared for the National Highway Traffic Safety Administration (NHTSA) by Harbridge House, Inc., in November 1978.

Before describing my analysis of the Harbridge House report, I would like to provide the necessary setting in which it came about. Typically, subsequent to the submission of a draft contract report, the Office of Research and Development in NHTSA, which is the office that manages the vast majority of our contractor efforts, circulates the report among the various offices in the Agency for a review of its technical adequacy and completeness.

When the Office of Research and Development transmitted the Harbridge House Report to my office, my staff performed its review function and returned to the contract manager an internal memorandum espousing what we believed were areas of weakness in the report. Generally, these critiques are not public but are summarized and, where appropriate, transmitted to the contractor for review. Unfortunately, prior to completion of the Agency's review process, the subject report had been given to various automobile manufacturers by the contractor. Since the report had essentially been released publicly, the Agency felt it necessary to make my office's critique available as well. Hence, on November 7, 1978, both the report and the analysis were placed in a public docket so that members of the general public, who did not have the opportunity to see the draft report, and automobile manufacturers, who did, would have equal access to both the report and the criticism of it. Equal, simultaneous access to information by all interested parties is essential if objective rulemaking is to occur. The publication of our comments on the Harbridge House report was deemed necessary to show that NHTSA did not necessarily support its analyses or conclusions and had not had time to review the report before its premature release by Harbridge House.

Having outlined the setting and chronology of events leading to the preparation of our comments, I will cite the basic concerns expressed in that critique. At the outset, I would like to note that the report contained much factual information which has proved useful to the Agency. The synopsis which Harbridge House submitted on past corporate strategies has been of particular benefit in understanding how the industry has evolved and how the individual manufacturers arrived at their current market and financial positions. However, the major problems contained in the report were in the section on "future scenarios."

Volume II of the draft report, Future Scenarios, and sections in Volume I, Corporate Strategies, which are concerned with strategies to 1985, contained predictions based upon unsubstantiated information. Any projections of future courses of action are only as good as the data upon which they are based. But, Harbridge House did not adequately analyze their starting points. For example, Harbridge House assumed that all future, incremental increases in capital investments would be due to regulatory requirements. However, there is no precept of which we are aware that states that automobile companies will only increase capital investments when required to comply with regulations. Automobile industry costs are categorized in two ways -- fixed, or capital, and variable costs. The mix of these two items is somewhat interchangeable in the production of an automobile. For instance, a company might decide to increase its capital investment so as to automate much of its assembly activities. This, in turn, would reduce its variable costs related to labor. Often, a company may adjust this in order to increase productivity. But, the Harbridge House analysis did not consider these additional possibilities. It gave little basis for its conclusion that only regulations were responsible for increased capital investments and was, therefore, fundamentally deficient.

Throughout the entire report, Harbridge House failed to differentiate industry capital spending plans from those investments which might be related to regulatory compliance. This analytical oversight diminished the usefulness of the findings of the report in that there was no discussion or analysis of which regulations were forcing the cited expenditures, when they were to be made, or if the regulation-generated expenditures, as calculated by Harbridge House, could be offset by normal business expenditures. For example, it is unclear whether all "additional" capital expenditures, as calculated by Harbridge House, are induced by government regulations. Even if the bulk of incremental investments were to be used by the companies to improve fuel economy, there is still the question of whether the investments are market-induced or generated by regulations. For instance, there is no clear-cut answer to the question of whether the decision to produce front wheel drive instead of rear wheel drive cars was "required" by regulations, consumer-generated or a response to one's competitors.

As it has turned out, the market's demands have leaped ahead of the fuel economy regulations, making it imperative for the manufacturers' survivability to produce the most fuel efficient car they possibly can. In fact, the automobile manufacturers have been very dedicated to not only achieving, but exceeding the standards. Each year the companies have far surpassed the levels set by the regulations, with some domestic manufacturers exceeding them by more than one and one-half miles per gallon for this model year.

Given the strides made by the manufacturers in actually exceeding the standards, and since it requires capital investments to exceed them in addition to just achieving them, it is indefensible for Harbridge House to have simply assigned all the increase in capital expenditures to regulatory compliance when corporate decisions have been made to exceed the minimum requirements of those regulations.

Another important weakness in the Harbridge House data base is focused on the source of the projected spending plans. Harbridge House accepted, unquestioningly, the industry's announced spending plans as being essential for meeting regulations, rather than developing an independent estimate based upon information gathered from a variety of sources, including the Agency. Looking at the industry from only one vantage point provides an unacceptable bias -- all sources should have been explored and then conclusions drawn. From a regulatory perspective, one has to look at all sources. Additional information, including the Agency's cost figures, were available to Harbridge House at the time of the study; however, this information was not considered in their analysis.

As another example of the weakness in the analysis, Harbridge House projected that the Ford Motor Company must spend $1.9 billion per year to meet new regulations while Ford, itself has estimated this figure would be 25 percent lower. Further, Harbridge House concluded that Ford, with half the volume of GM, would need to spend $15.3 billion for regulatory compliance over the 1978-1985 period while GM would need to spend only $15.0 billion. That meant that for Ford to comply with unnamed regulations, they would have had to invest twice as much as GM on a per car basis. However, capital investments, whether related to regulatory compliance or not, have historically been proportional to corporate sales. Consequently, either Ford was choosing an extremely costly path for compliance with these unknown regulations, or GM had a secret, low-cost means of compliance, or there were errors in the analysis. We suspected the latter was the case.

An important flaw existed in the assumptions used in the analysis relating to needed capital, profits and the magnitude of a possible recession. First, Harbridge House accepted industry spending plans without any analysis as to how much investment was really necessary to meet government requirements. Second, Harbridge House used record profit years (1976-77) as one of the bases for their analysis and assumed 8 percent annual increases. However, since 1965, profits have increased at only 4 percent per annum. Finally, Harbridge House concluded that it is regulations which will strain company finances, without ever examining the actual costs of the regulations. The aforementioned weaknesses in the Harbridge House report obstruct the ready acceptance of their conclusions. Harbridge House did not justify many of the conclusions and relied upon too many unsubstantiated assumptions.

In summary, it is not the conclusions, per se, of the report with which we took issue, but rather the manner in which the conclusions were reached. That is, there was a lack of traceability of the conclusions, from the assumptions made through the analyses conducted. Harbridge House did present some very sound, documented conclusions such as (1) the monolithic nature of the automobile industry, (2) the differing financial structures among companies with the consequent variance in economic impacts among manufacturers, etc. Yet, many of their financial analyses were based upon questionable assumptions rendering the conclusions unreliable.

Further, Harbridge House provided scant information concerning the sensitivity of its conclusions to the assumptions used. As an example, they stated that regulations would result in $33 billion in existing capital expenditures over the 1978-1985 period. But, if the starting point for the analysis was changed to allow use of the latest available information, the $33 billion figure would be reduced to $12 billion. It is this type of analysis, which was not included, that is essential to understanding the conclusions of the report.

In closing, I would like to impress upon the Subcommittee that our comments on the Harbridge House report were not based on a disagreement or agreement with their conclusions. In fact, some of our criticisms would have led to more "adverse" financial conclusions than contained in the Harbridge House Report. At times, we found Harbridge House to be too generous. Our concerns focused on the lack of justification for those conclusions. I want to emphasize this point to assure you that we are not a regulatory agency which is afraid to hear bad news. The regulatory process requires valid, empirical evidence and analysis for all conclusions in order to maintain public responsibility and regulatory equity.

This completes my prepared statement. I would be pleased to answer any questions you might have.