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# Establishment of an Automotive Industry

by Dr Joachim Zahn, Stuttgart \*

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**D**evelopment policy is something which characterises the relationship between the highly industrial nations and the so-called developing countries. In the following some general reflections are presented—using the development of the automotive industry in Iran as a concrete example—which can perhaps be of value in treating this problem, which is so important all over the world.

The example of the long-term Daimler-Benz commitment in Iran clearly shows the stages of setting up a national automotive economy in the development of a large country, a development which should lead from a largely agricultural economy to a productive national industrial potential providing the basis for the livelihood of up to 75 p.c. of the population, as the Shah describes the aim of his development policy for the next 25-30 years, when the total population figure will perhaps have risen to 40-45 mn<sup>1</sup>.

## Development in Stages

In general, the stages in setting up a national automotive economy can be individually characterised as follows:

□ The creation of an infrastructure centering on the extension of the road network, communications and transport. At this first stage the demand for motor vehicles is covered by imports, and at this point in a country's development the demand for commercial vehicles (trucks and buses), i.e. meeting the needs of collective and goods transport traffic, takes priority over individual traffic with passenger cars. Commercial vehicle traffic applies not only to long-distance traffic between those areas not connected by railway lines—this also means that remote settle-

ments and economic areas are brought closer to the centres of activity—but also to short-distance traffic and the traffic needs of a metropolis, as the example of Sherkate Vahed, the city bus transport company in Teheran, illustrates. Beyond this an extensive network of petrol stations and workshops is particularly important for the initiation of new workers into technical and skilled activities. In so far as motorisation makes an important contribution even at this stage to raising the level of education in a country and imparting knowledge.

□ In the second stage, the beginning of partial industrialisation, that is to say, changing over to the possibilities of a developing industry and its suppliers takes place. For the automotive economy this brings the assembly of imported parts with increasing "local content", i.e. increasing national manufacture, starting naturally with the simplest components. The development in Iran can be seen particularly clearly in the bus sector. In 1963, 86 p.c. of a total of 830 buses were imported, whereas in 1964, 46 p.c. of the 1,300 buses sold were already being assembled or manufactured in Iran. In 1969 it is planned to manufacture 6,000 buses, of which only 2.5 p.c. are to be imported as finished products. This bus production, involving high labour costs, enables a national share of up to 60 p.c. (with trucks up to 40 p.c.) through the use of local labour.

□ In the third stage, manufacturing is extended until there is almost entirely national production, as has been taking place in Iran since about 1966. This stage means a certain withdrawal from the international market, which gives rise to a number of questions and problems.

□ Re-entry into the world-wide free goods exchange is the fourth stage and ought to be an attainable future goal for Iran on the basis of the country's technical and economic capability. As a parallel for stage four, one can mention Japan, which has meanwhile reached this stage, although only with regard to exports. Japan, con-

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\* Shortened and translated version of a talk given by Dr Zahn, Spokesman for the Board of Directors of the Daimler-Benz AG, under the title "The Contribution of the Automotive Industry to the Setting-up of a Modern Economy — presented by the example of Iran", before the German-Iranian Society in Bad Godesberg.

<sup>1</sup> Compare Pahlavi, Mohammed Reza Shah, "The White Revolution", Teheran, 1967, pages 42/43.

trary to expectations, has in no way reopened the door to free competition on the import side. However, it is to be assumed that this is a passing phase.

### **Precondition for Foreign Commitment**

In all of these stages the investment of foreign capital plays an important part. There is no generally valid formula for the economic development of a country nor are the preconditions for setting up a certain branch of industry the same in every country. However, certain experiences can be transferred from country to country.

There are a number of countries which, on the basis of their prevailing conditions or the degree to which their resources are used, do not, or do not yet, offer the preconditions for industrial development. There is, however, also a category of countries, to which Iran belongs, which possess natural riches and have already reached a stage of development where they have achieved the "take-off" and could leave the "vicious circle of poverty".

The final deciding factor for a foreign partner in assessing his commitment is the question of confidence, i.e. the confidence he may be able to place in the social and political order and stability of a country, open-mindedness regarding managerial enterprise, not only on the part of industrial partners, but also on the part of the government and the authoritative planning offices, as well as the technical disposition and ability of the available workers.

### **Problems of National Production**

The transition to strengthened national production with increasingly high "local content" brings a number of problems for those responsible for the economic planning and development of a country—problems which vary according to the peculiarities of each industry. The special problems encountered in the automotive industry are:

□ The complexity of the product in conjunction with the complicated manufacturing technique necessitates a high technical standard, which mostly has to be "imported" by the foreign partners by means of licences and by imparting technical "know-how" until national development has reached the necessary level. Here too the overall effect of such a developing branch of industry on the level of a country's technical knowledge is considerable, and makes the long-term close connection with foreign partners an important factor in the fostering and preservation of technical ability.

□ The cheap, large-scale series production of large firms in industrial countries determines the world market price of individual products. In view of this the competitiveness of national production, which has to be on a smaller scale, will naturally be at a disadvantage. This necessitates, as far as investments for national production are concerned, a careful balance between the extent of production aimed at and the proportion of imports envisaged.

□ The extent of production in an automobile manufacturer's own plants also varies, of course, in the large manufacturing countries (e.g. USA, Federal Republic of Germany). The wide range of suppliers, who themselves must also possess the necessary "know-how", as well as, for reasons of cost, a minimum production volume, is significant here.

It is obvious that, as far as costs are concerned, in the first stage, when the financing of supplies is essentially the foremost consideration, the country is able to make full use of the advantages of international competition and the high number of those who have something to offer. This advantage is, however, more or less forfeited as the proportion of national manufacture and the corresponding home supplies increases, which in its turn also necessitates appropriate tariff protection for industrialisation. This situation can lead to rising costs for the product intended for national production, if there is not a sufficiently large market to guarantee the economies of mass production.

### **Danger of Wrong Decisions**

Indeed, in many countries arrangements have been made at the second stage which have later proved to be a burden on the country's economy. Therefore, one of the most essential tasks is to avoid a development along the wrong lines. The problem of selecting the products suitable for industrialisation and determining the degree to which imports should be substituted by national production usually becomes clear at the third stage. In actual fact, however, the decisions often have to be made at the second stage. The Pearson Report<sup>2</sup>, for example, points out that many developing countries lay too much stress on import substitution, while neglecting the promotion of their own partly available, partly expandable competitive export industry. In most cases foreign currency is not saved to that extent and in that period expected, because, quite simply, higher expenses for machines and equipment take the place of those for imported finished

<sup>2</sup> Lester B. Pearson, "Partners in Development", Praeger Publishers, New York 1969, page 281.

products without there being sufficient economic revenue in every case.

One of the most important functions of private enterprise competition is to avoid uneconomic investments and to divert investments to those fields guaranteeing particular commercial efficiency on a private and national enterprise basis. This function of competition, however, is limited or invalidated as soon as—in the automotive industry, for example, upon transition to the second or third stage—a market is closed to open competition.

The considerable profits often gained by the national economy in such a situation through tariff protection, frequently going beyond the necessary measure as far as costs are concerned, can lead to a false assessment of the expediency of investments and other dispositions of the national company undoubtedly favoured by this tariff protection. This is followed by a rise in home prices and a corresponding burden on the entire national economy. On the other hand, it could

result in excessive and too varied production. This is a general problem of every development policy of this kind.

### Principles of Iranian Industrial Policy

In Iran concessions for industrial projects are granted only after very careful consideration of the desirability of the enterprise from this very angle and, in particular, with a view to the priority use of private capital. This does not, of course, exclude the need for the government to bring in branches of industry to remote and backward areas of the country, as almost all industrial countries have to do in underdeveloped areas.

Industrial development on a private enterprise basis also demands, for the formation of a modern industrial society, a possibility for the general public to share in the production capital above all of the large companies. This is surely a problem shared by large industrial countries in a similar way and to a similar extent.

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Large octavo, 144 pages, 1969, clothbound, DM 68.—

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# GERMAN PRISM

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## **The Federal Republic's Economic Situation**

The economic situation in the Federal Republic has been formed by development trends that at first sight may appear to be contradictory. While demand expansion of trade and industry as a whole, which stimulated the long-lasting boom, is now declining noticeably, the cost and price increase continues unabatedly. Declining pressure of demand for capital goods and a for the time being unbroken price increase are a constellation that confronts the Government's economic policy with a true dilemma. If it intended to fight the price increase with a vigorous policy of restriction it would conjure up the risk of an exaggerated decline of growth, which in view of a weakening international economic trend might easily lead to stagnation and recession. On the other hand, if the Government intended to rely alone on the effects of the already visible endogenous influences of a calming nature, it must be prepared to tolerate a relatively high and completely indiscussible rise in prices.

The economic task of achieving stabilisation without stagnation would be made much easier to solve if, on the one hand, the entrepreneurs would renounce a full exploitation of the presently still existing margins for price increases, and, on the other hand, the trade unions would not use the present situation in the labour market for demanding extreme wage rises. On January 22/23, 1970, the Federal Government agreed on a domestic stabilisation programme which leaves the market partners and the parties to wage agreements enough scope. At present the Government examines whether additional stabilisation measures will have to be taken, and it will carefully investigate which instruments will have to be applied at what time.

## **8.5 Million Employed in German Industry**

At the end of November 1969 the number of persons employed in the West German industry was 8,503,100 and thus smaller only by 11,500 than at its highest peak before the recession at the end of November 1965. During this period of exactly four years a noticeable shift towards the capital goods industries has

occurred, that now employ 213,000 persons more than in 1965. All other industrial branches registered a reduction of persons employed in November 1969 as compared with the situation four years ago: mining by 149,700, consumer goods industries by 35,300. In the basic materials industries the number of persons employed declined by 24,300 vis-à-vis 1965. While in the chemical industry the labour force rose by 45,200 persons, the non-metallic minerals industry lost 35,300, the iron and steel producing industry 24,400 and foundries 17,400 workers. The food-processing industry also experienced a decline of personal by 15,400 heads.

German tourists travel more in their own country than they did in former years. Turnovers of the hotel industry increased by 7.7 p.c. vis-à-vis 1968. From January to November 1969 German tourists have spent 154.7 nights in German hotels, almost 5 p.c. more than in the preceding year's corresponding period. The turnovers of the total hotel and restaurant business increased by 5.9 p.c. This has been the highest growth rate since 1962.

## **German Tourists Travel More in Germany**

## **Ten Years of Federal Guarantees for Capital Investment Abroad**

Ten years ago the Federal Government's instruments applicable to its guarantee policies were extended by the possibility of insuring German investments abroad—particularly in developing countries—against political risks that cannot be calculated in advance by the entrepreneurs themselves. Since then more than 670 applications to the tune of DM 1.2 bn have been approved. The guarantees for capital investment acquired an increasing importance in the 10 years of their existence. Today they are one of the major instruments available to the Federal Government as regards private development aid. Moreover, there are of course other Federal measures for improving investment activities in the less developed countries as e.g. a special tax pertaining to development aid, antidouble tax treaties, investment promotion agreements, the German Development Association, ERP credits for establishments abroad, etc.

During the past 10 years this guarantee procedure has several times been improved by the Inter-Ministerial Committee. Among its members are certain Federal Ministries, mandatories of the Federal Government, i.e. Deutsche Revisions- und Treuhand-AG, Hamburg (German Auditory and Trust Company) and Hermes-Kreditversicherungs-AG (Hermes Credit Insurance Company). Experts from business quarters have been asked for their cooperation. At its last meeting, on February 12, 1970, the Inter-Ministerial Committee has again improved the guarantee conditions quite considerably by reducing the annual fee from 0.8 p.c. to 0.5 p.c., by lowering the proportion of credits risks which exporters are required to carry themselves from hitherto 10 p.c. to 5 p.c. as well as by enabling the inclusion of reinvested profits into the guarantee.

### **Draft Statute for the Abolition of the Tax on Coupons**

On March 3, 1970, the Federal Government agreed to a draft statute signed by the Federal Minister of Economics, Professor Schiller, and the Federal Minister of Finance, Möller.

This draft law will abolish the 25 p.c. tax on coupons for German fixed-interest-bearing securities owned by foreigners. It will be submitted immediately to the Bundesrat (Upper House of Parliament) for its approval.

This tax on coupons introduced in 1965 as an instrument of currency and credit policy is now supposed to be obsolete. Besides, the abolition of this tax will support Government objectives with regard to integration and balance of payments policies. However, after the raising of the bank rate as a means of slowing down inflation, doubts about the timing of this draft statute seem to be quite justified.

### **"Internationale Grüne Woche Berlin 1970" Very Successful**

The "Internationale Grüne Woche", the famous agricultural exhibition in Berlin, ended on February 8, 1970, after 10 days duration. The growth rate of turnovers as compared

with the previous year amounted to between 25 and 55 p.c. This exhibition proved to be a modern type of fair that in the seventies will be important for farmers and consumers alike. For German farming it is valuable as an "Information, Performance and Publicity Show". Foreigners consider "Grüne Woche" as an "important centre of international interest".

Due to keen international competition—995 exhibitors of a total of 1,376 came from abroad—"Grüne Woche" proved to be a "High School of Marketing" for farmers. This largest European agricultural display taking place in winter serves farming in the very sector that is gaining ever growing importance, i.e. the marketing of farm produce. According to the results of a poll a great majority of exhibitors is very satisfied with the business success of "Internationale Grüne Woche", and there were no negative comments at all.

### **Constitution of the German- Jugoslav Coopera- tion Committee**

Apart from its other activities in the field of East-West Policy the Federal Government by all means did not forget Jugoslavia. On March 4, 1970, the Yugoslav Minister, Toma

Granfil, and the Federal Minister of Economics, Professor Schiller, opened the constituent meeting of the German-Jugoslav Committee for Economic, Industrial and Technological Cooperation. Basis of this Committee is the Yugoslav-German agreement of February 10, 1969, that is to intensify the already existing process of cooperation. Minister Schiller in an address given to the meeting pointed out that last year the Federal Republic of Germany advanced to the first position among Jugoslavia's trade partners. In 1969 Yugoslav deliveries to the Federal Republic could be increased by almost 50 p.c. vis-à-vis the previous year's level. This development reflects clearly the efficiency of Jugoslavia's industry.

### **German Bi- lateral Long- Term Capital Aid**

Bilateral capital aid amounts to almost 50 p.c. of total development aid given by the Government. Since 1960 Asia with its vast population is far ahead of other continents as a

receiver of capital aid. Considering the sectors of promotion, the differences between aid measures tied or not tied to certain projects must be pointed out. Corresponding with German guidelines for giving aid the major part of it (nearly 80 p.c.) has been spent on specified industrial projects. Here the emphasis was on infrastructure projects. The share of aid not tied to projects (a good 20 p.c.) consisted mainly in goods as a form of maintenance support: In other words, it served the financing of vital civilian imports of developing countries that were necessary for the maintenance and extension of already existing productive capacities.

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Iran has made astonishing progress in this direction in just a few years, and this progress led, among other things, to the development of a private capital market—the expanding stock market is proof of this—and the increasing activity of national and foreign banks. In its recommendations the already mentioned Pearson Commission also comes to the conclusion that the most important single measure for improving the climate for foreign investors is the strengthening of the position of the private sector within the economy.

#### **System for Promotion of Private Investments**

The system which has been evolved in Iran represents an optimal reciprocal supplementing of private investors and state directed skeleton planning and financial aid. A number of credit institutes, such as the "Industrial Mining and Development Bank of Iran" (IMDBI), the "Industrial Credit Bank" and the "Bank Melli" which, since the "Bank Markazi" took over the function of the Central Bank, only has financial tasks in industry and trade, belong to the most important instruments as trustees of the state finance contribution.

With this system, a happy synthesis has been found of those organisational forms which have already been tried out in a number of other countries, not only in developing but also in industrial countries, e.g. in Spain and Italy. In this connection I should like to give two points particular mention, from the example of the Daimler-Benz AG in founding an engine factory in Iran in conjunction with Iranian partners:

☐ Stress on the concept of private economy also for direct state investment.

☐ In our mutual consideration with the planning authorities and our Iranian partners, as regards the product to be industrialised, the predominant precondition was that of economically rational production. This applies, of course, far more to diesel engines, which we will now be manufacturing, than, for example, to the production of a certain passenger car model. It is obvious that the prospects for economical production of a Mercedes-Benz passenger car with its sales possibilities inevitably limited by its price and the market, are less favourable. On the other hand, heavy-duty diesel engines are particularly needed by Iran's striving industry, with its almost unlimited demand for means of goods transport, as well as with its increasing passenger car traffic.

The question of selecting products from the point of view of purposefulness seems to me to be worthy of further explanation. Here there is al-

ways the problem as to which types of production the factors "capital" and "trained personnel", which in these countries in particular are usually very hard to come by, should be assigned to. The second factor usually provides the worst problem. Whereas capital can, to a certain extent, be obtained— if need be from abroad—the procurement of sufficiently "trained personnel" can be a long job.

#### **Selection of Products**

It is therefore a question of using these factors for production:

☐ in which local manufacture is really necessitated by the country's particular circumstances, and

☐ in branches where it is possible, at least after a certain transition period, to reach world market standards, not only from the point of view of quality, but also that of cost.

It is true that tariff protection can promote production, with excessive costs in comparison with the world market, at home, and that it can also keep this up for some time, but at the same time the extent of the tariff protection is a gauge as to what extent the national economy is burdened by such production at the expense of the consumer. Once differences arise in the cost level they are very difficult to remove. There are a number of examples where this way was taken for reasons of national prestige or simply in schematic application of planning principles, resulting in considerable disadvantages for the country and, finally, for the industry concerned. This problem particularly applies to top technical products, for which, in their category, there may be a real demand, but which will never become objects of mass consumption. How far the problem of insufficient market volume can be solved by export depends on the specific market and cost situation, and must, therefore, be examined according to the individual case.

International exchange remains as useful as ever, especially for top products. In these cases it is therefore worth making extensive use of the cost advantages of international division of labour, as is shown particularly clearly in the automotive field by the example of Switzerland. Daimler-Benz, with its wide programme, is in the position to, and is also ready to offer other economic alternatives, as in this case in Iran, in the field of commercial vehicles and engines.

It is interesting to note that those very countries in which industrial development and industrial thinking are most advanced show particular understanding for these matters, while other countries give prestige or similar factors far greater priority over economic thinking.