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## 33 Years Ago, Tariffs Saved Harley-Davidson Inc. -- or Did They?

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History has taught us that thirty-three years ago, President Ronald Reagan saved **Harley-Davidson** (NYSE:HOG) by imposing draconian import tariffs on Japanese motorcycles. By giving the sole American motorcycle maker some breathing room from competition to retool, Harley was able to get its act together, turn profitable, and even request the tariff protection be ended early.

In today's political climate, the story seems to have particular relevance. But the history books seem to have gotten it wrong. The tariffs actually did little to help Harley-Davidson survive, though they likely did cost some workers their jobs and raised costs for consumers. What actually saved Harley-Davidson was Harley-Davidson.

### **Pulling itself up by its bootstraps**

After being bought out in 1981 by a group of investors led by a former AMF executive, Harley-Davidson immediately set about to remake itself. Over the next several years it:

- Retooled its factories
- Introduced the innovative 1340 cc V2 Evolution engine
- Developed the Softail hidden rear suspension system
- Switched from rigid-mounted engines to rubber-mounted
- Introduced just-in-time inventory management systems

With an economic recession causing sales of all motorcycles to slide, with even Japanese manufacturers like **Honda Motors** (NYSE:HMC), Kawasaki, and Yamaha overestimating demand, Harley's delicate financial condition couldn't afford the discounting the oversupply was causing. Despite the Japanese bike makers offering to help Harley make it through the crunch by giving it technological assistance and providing tens of millions of dollar in loans to keep it

going, Harley instead chose protectionism and petitioned the Reagan administration in 1982 to raise tariffs.

### **And then there was one**

As it had been since the 1940s, Harley-Davidson was the U.S. bike industry, being the lone American bike maker left in the market, although Honda and Kawasaki did have a single plant each located in the U.S. But with Harley's global market share slipping, the U.S. International Trade Commission determined that Honda, Kawasaki, Suzuki, and Yamaha had hurt Harley's business, and advocated a tariff hike. Reagan ended up raising the tariffs from 4.4% to 49.4%, though the rates were to fall by a set amount each year thereafter, with their removal or extension decided after five years.

However, Harley-Davidson staged a dramatic recovery, with sales rising so fast that after just four years it petitioned the government to lift the tariffs, saying it no longer needed protection, making this a simple success story of targeted trade protection. Wait, not so fast!

### **The bigger, the better**

Harley-Davidson was and is a big-bike maker, with the engine displacements of its bikes mostly exceeding 1,000 cubic centimeters. Every attempt Harley has made at diversifying to smaller concepts over the years has met with failure. Aermacchi motorcycles, Sprints, RVs, Buells, MV Agustas, lawn mower engines -- they've all been abject failures. So far, though, it seems it is having some success with its smaller 500 and 750 Street models.

And that was where Japan's bike makers were at that time, with research from the Cato Institute saying about half of their bikes larger than 700 cc were 750 cc. Because the tariffs only affected bikes with 700 cc engines and above, the immediate effect was that manufacturers like Yamaha began making 699 cc engines to get around the tariffs. Honda and Kawasaki simply transferred more production to their U.S. plants.

According to Japan's Research Institute of Economy, Trade and Industry (RIETI), sales of smaller-engine Japanese bikes jumped from 43% of the total to 60% in 1983 and afterward.

The tariffs also caused prices to rise, and not just on Japanese bikes, but on Harleys, too. Then, as now, Harleys commanded a premium, and for the first two years after the tariffs were imposed, they maintained the same percentage price difference over their Japanese rivals. It was only after the U.S. agreed to devalue the dollar in 1985 that the price of Japan's bikes rose substantially faster than those of Harley-Davidson.

### **Taking care of business**

Ultimately, the RIETI found it was Harley-Davidson's own initiatives -- the modernized factories, the new engines, the better inventory control -- that played the biggest role in its turnaround. Indeed, during this time, the number of motorcycles with defective parts Harley produced plunged from around 50% to just 2%.

Because the tariffs affected only a relatively small percentage of bikes -- since motorcycles from Germany, Italy, the U.K., and elsewhere were granted exceptions to the tariffs and the Japanese were able to get around their effect while further innovating -- it's estimated the tariffs accounted for only 6% of the sales increase Harley enjoyed in the aftermath; the rest was due to the bike maker's own efforts.

And it wasn't necessarily because Harley had become so profitable and strong that it requested the tariffs be lifted. Because Honda and Kawasaki had manufacturing plants here, they also enjoyed trade protection from their overseas rivals. With the probability they were shifting production to those U.S. plants, Harley risked seeing its competition get even stronger the longer the tariffs remained in place.

Even though the Harley-Davidson of today faces sliding sales, dwindling profits, and stiff competition from **Polaris Industries**, which is stealing market share after successfully reintroducing the Indian Motorcycle nameplate to go along with its existing big-bike Victory brand, it isn't in the same condition it was three decades ago.

Presidential politics are raising the specter of protectionism as a valid policy option once more, but using Harley-Davidson as a case study to validate them indicates that perhaps the wrong history lesson has been learned.

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