

Our Hapless Automakers

The choice before Congress is bankruptcy now or bankruptcy later

BY IRWIN M. STELZER

Set out a giant honey pot, and the bears will come. And the more bearish they are about their prospects, the faster they will come and the louder they will grunt. The Bush administration presides over a giant honey pot, containing some \$350 billion. And a smaller one, with a mere \$25 billion already promised to the once-big, now shriveled three U.S. automakers. Not enough to appease the domestic automakers' desire for a sweetener. "Please sir, can we have more?" say GM, Ford, and Chrysler. If only Congress and the White House would dip into the money originally intended to help financial institutions weather the current credit crisis, they say.

Start with the smaller pot, already authorized by Congress. This \$25 billion is available subject to a Democratic-inserted requirement that the companies use the money only for research into battery development and other very green ventures. No green, no greenbacks. President Bush says that if GM is on the verge of bankruptcy all the Democrats in Congress have to do is remove the conditions, and the money will flow to GM and others to meet their immediate cash needs. By the time they burn through that cash pile—at current rates that will take a few months—Barack Obama will be sitting in the Oval Office, from which perch he can decide how much taxpayer money he wants to commit to satisfying the seemingly insatiable appetite of the cash-guzzling trio. Insiders say he has an immediate additional \$25 billion in mind, but analysts at Goldman Sachs say that GM alone will need almost half that amount in order to survive the current downturn, never mind finance a major restructuring.

This is really only the tip of a policy iceberg. In days past what America is now involved in was known as

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"industrial policy," the government picking winners in which it would invest taxpayer money. The relief and stimulus effort didn't start that way. Congress was persuaded to authorize two \$350 billion tranches to ease conditions in credit markets by having the government buy shaky IOUs currently on bank balance sheets. That morphed into the later plan to inject capital into the major and some lesser banks. Then came the unintended consequence, the cries of "Why the banks and not us?" To which Treasury Secretary Hank Paulson responds that he does not have the legal authority to transfer money to a purpose not authorized in the Troubled Assets Relief Program (TARP) legislation, a view that Majority Leader Harry Reid considers excessively prissy and legalistic.

Which is where we are now, with the auto companies in the lead, but other industries attempting to dip their paws into the honey pot. Even the advertising industry is talking about the devastating effect of a withdrawal of GM sponsorship from such events as the Super Bowl and the layoffs that would occur on Madison Avenue if help—for it as well as its car making clients?—is not forthcoming. Passage of this loan package would "set a terrible precedent," warns Texas senator Kay Bailey Hutchison. "Why not the airline industry? Why not the other industries?"

The politics are clear. The autoworkers' union that dominates U.S. producers but has failed to organize the plants of foreign companies making cars here in America, helped candidate Obama, and the president-elect has never, never done anything to antagonize any union, much less the UAW, which boasts more than one million active and retired members "in virtually every sector of the economy" and of its "3,100 contracts with some 2,000 employers"—a lot more potent politically than merely the 239,000 workers employed by GM, Ford, and Chrysler. So Obama has promised to help the American-brand automobile makers, although he has been vague on whether the check they get will be a blank one, or be conditioned on firing the CEOs and some of the directors, limiting executive pay, and appointing some sort of government czar to supervise investment, marketing,

and other decisions, as was done with the airlines after their post-9/11 bailout. Think of it: a government that hasn't been able to figure out how to give away \$700 billion in an optimal way imagines it can decide what sort of vehicles will sell well.

No problem—all of the executives who spent most of last week rattling their begging bowls before congressional committees expressed eagerness to welcome a government oversight/advisory board to their boardrooms. A small price to pay for \$25 billion at an initial interest rate of 5 percent.

Two things surprised the auto companies. The first is the weight of the baggage carried by their principal spokesman, GM CEO Rick Wagoner. “We don't like being here asking for this,” Wagoner testified. And he liked being there even less when the executives were asked for a showing of hands by all those who had flown to the hearings on commercial airliners (cost \$300) rather than in private jets (cost \$20,000) and neither he nor his colleagues could raise their hands.

Wagoner's company is in worse shape than Chrysler, and in far worse shape than Ford, which says it can survive without aid through 2009. Wagoner, therefore, has to lead the charge for an immediate infusion of taxpayer cash, and the \$10 million spent by GM so far this year on lobbying, plus his own testimony, just doesn't seem to be carrying the day. In part that is because he has the mission impossible of arguing that GM's problems stem from a short-term liquidity crisis caused by high oil prices, tight credit and consumer reluctance to spend—all forces beyond the control of management, which has a sound long-term plan for recovery. Our problem “can be traced right to the crisis on Wall Street,” Wagoner contends.

Unfortunately for his credibility as a victim of recent circumstances beyond his control, Wagoner has been CEO since 2000 and at GM for 31 years, during which period its market share has shriveled from over 50 percent to 20 percent, its losses have mounted so that it is hemorrhaging more than \$2 billion in cash every month, and repeated efforts to assure the survival of this “dinosaur,” to use Senator Richard Shelby's descriptive term, have failed. The sad truth is that GM became a candidate for the ash heap of history long before the economy's current woes. It has too many workers making too many cars that too few people want, being sold through too many dealers at prices too low to turn a profit, with too many vehicles going to rental fleets which eventually glut the used car market. And despite all of the Detroit automakers' claims about improved quality,

its vehicles still lag far behind those of its European competitors in resale value. No cars produced by GM, Ford, and Chrysler rank in the top ten in the authoritative Kelley Blue Book. After five years a typical Chrysler product retains merely 24 percent of its original sticker price, whereas Honda's brands hold onto 45 percent of their original value. That allows the foreign-owned automakers operating in this country to offer more attractive lease terms, still another competitive advantage that domestic companies have made no progress in overcoming.

A second surprise for GM, Ford, and Chrysler has been the extent and intensity of the opposition to a bailout. Republicans and conservatives who believe with economist Allan Meltzer that capitalism without failure is like religion without sin were expected to oppose any bailout. So were longtime opponents of the industry's management, which has been rightly chastised for its failure to increase productivity, but unjustly criticized for emphasizing the manufacture of vehicles consumers want rather than those environmentalists wish consumers would want. Finally, the anti-bailout crowd was expected to include those who feel the UAW has for years extracted such lush benefits packages from the companies that consumers overpaid for vehicles until foreign competitors gained a foothold here. If you doubt that GM's union contracts are a major source of its inability to compete, consider this: Where it is not burdened with such legacy costs, GM is a

highly successful company. It produces more cars outside of North America than in it, and is the market leader in China, where it sells over one million cars annually.

But no one guessed that politicians in states in which nonunion foreign automakers such as Toyota, Nissan, Honda, and BMW are providing good jobs for more than 113,000 workers would be quite so vigorous in protecting those companies from unfair, taxpayer-subsidized competition. Alabama, home to Senator Shelby, leader of what might be called the “Drop Dead Detroit” crowd, is one of seven states that is home to a Toyota plant (it has R&D facilities in three other states); Toyota also operates manufacturing facilities in Indiana, Kentucky, West Virginia, Texas, and Mississippi, and an even more far-flung network of suppliers. Nissan operates production facilities in Mississippi and Tennessee, as does BMW in South Carolina. Honda has plants, and therefore political supporters, in five states, according to Matthew Slaughter, dean of Dartmouth's Tuck School of Business.



Ah, the good old days

For whatever reason, the Democratic leadership in the House and Senate cannot even count on vigorous support from its own ranks. Senate Banking chairman Christopher Dodd, a reluctant supporter of aid, says, "They're seeking treatment for wounds that, I believe, are largely self-inflicted." And Democrat Jon Tester says that people in his home state of Montana "are experiencing bailout fatigue." The lack of enthusiasm from many Democrats has combined with the active opposition of most Republicans to force the Democratic leadership to throw in the sponge. At midweek Reid gave up efforts to push through a bill that would have allocated \$25 billion from the TARP program to the Detroit three. At this writing it seems likely that the administration will prevail, and that Congress, perhaps returning after Thanksgiving to get the necessary legislation done, will override Nancy Pelosi's vociferous objections and remove most of the restrictions that have kept the Treasury from transferring the already agreed-upon \$25 billion from taxpayers to auto company coffers. Whether or not that happens, the auto companies will have to await the coming of President Obama before receiving the taxpayer-funded loans they seek—which he will make available, he says, only if he can be shown that "we are creating a bridge loan to somewhere as opposed to a bridge loan to nowhere." And then only if Reid satisfies him that he can get the votes he will need in the Senate, just one example of why the final outcomes of the Senate races in Georgia and Minnesota are so important.

The opposition to the bailout will not go away. And the case for refusing to drop more money into Detroit's bottomless pit is compelling. Michael Levine, research scholar and senior lecturer at NYU law school, pointed out in a *Wall Street Journal* op-ed piece that a bailout will do nothing to lighten the burden of the legacy costs under which GM and others labor. GM and Toyota have almost identical market shares, but GM pushes eight brands through almost 7,000 dealers while Toyota has fewer than 1,500 dealerships. Toyota's larger dealers are better able to advertise, stock, and service the cars they sell. GM knows it needs fewer brands and dealers, but the dealers are protected from termination by state laws. Only a bankruptcy court judge can spare GM the billions of dollars and years of time it would take to pare its dealer numbers to some efficient total.

The automakers know, too, that the relief they have so far been granted by the UAW—and Wagoner has succeeded in wringing a bit of mercy from the bosses of the UAW—will take years to have sufficient impact on costs to make them able to compete with made-in-America foreign brands. New hires will come in at lower wages, but with the age of GM employees averaging around

50 years, it will take a long process of attrition-through-retirement for labor costs to come down.

Worse still, the UAW boasts that its "unique strength . . . is the solidarity between its active and retired workers." So it is not prepared to budge on its program that has tens of thousands of laid-off workers assigned to a "Jobs Bank," with pay and benefits nearly equal to those paid to active workers. Only a bankruptcy court can cut through this barrier to the long-term viability of the three auto companies.

Bankruptcy is not an option, says Wagoner. Car companies are not airlines. Consumers will buy tickets on bankrupt airlines because their relationship with the carrier lasts only for the duration of the flight. But car purchasers are entering a long-term relationship with the manufacturer on whose warranty they must rely. Unfortunately for Wagoner, there is an easy fix to that problem: a government guarantee of warranties backing vehicles sold while GM (or Chrysler) is in bankruptcy. Throw in government guarantees of pension obligations, some retraining and other protection for older workers who might be adversely affected by rulings of the bankruptcy courts, and you have a compassionately conservative solution to the auto industry's problems.

But that is not to be, as some problems can't be fixed. Obama has promised the unions he will make an additional \$25 billion available and has announced that in his view viable companies will not emerge from the bankruptcy process. Members of the Congressional Black Caucus want assurance that \$1 billion will be allocated to support minority and ethnic auto dealers. Barney Frank wants an end to the "discrimination" that has the government bailing out white-collar workers at AIG but refusing help to blue-collar workers at GM. And no one wants to take note of the fact that foreigners make cars, including trucks and SUVs, and money here in the United States; that Ford's chances of survival would be increased if GM's excess capacity were removed from the industry; that our British friends poured billions into a failed attempt to rescue British Leyland; that replacing poor Rick Wagoner with a politicized, government-run advisory board is unlikely to produce the hard-headed change needed in the company's labor contract; and that studies by NYU professor David Yermack conclude that the capital wasted by our auto companies in the past decade would have been sufficient to acquire "all of the shares of Honda, Toyota, Nissan and Volkswagen."

The choice is bankruptcy now or bankruptcy later, and now beats later by at least \$50 billion. Senator Mike Enzi of Wyoming says that because the bill fails to address "the industry's crippling legacy costs . . . I would not be surprised if we find ourselves and the domestic auto industry in the same situation six months, or a year from now." He has it right. ♦