Auto Bailout: Lemon or Lemonade?

With the total tab for Washington's bailouts in excess of $8.3 trillion and with one economic sector after another looking for handouts, it is perhaps not surprising that the struggling automobile companies would have gotten in line. What is surprising, perhaps, is the amount of media and congressional attention devoted to the $14 billion auto bailout compared to the *total* bailout tab for all economic sectors. Not only is the total tab still growing, but there appears to be no end in sight.

Not that $14 billion is insignificant. Regardless of who's being bailed out, transferring wealth to a politically favored sector can only be done at the cost of hurting the economy as a whole. It rewards failure (successful companies do not get bailout money), encourages more bailouts, and results in more government control. The bailout of the auto industry is no different.

Financial Troubles

There is no question that the Big Three automakers — General Motors, Ford, and Chrysler — are in financial trouble. The Big Three are burning through billions in reserves just to continue operating, even as they face a tightening credit market, plummeting share values (between 70- and 82-percent drops over the last year, with GM currently worth less than toy maker Mattel), and a dramatic slump in sales — the worst in decades. In addition, sales of the highly profitable but gas-guzzling SUV's have been in steep decline since the surge in gasoline prices, dealing another revenue blow to the beleaguered automakers.

One of the most frequently blamed culprits in this debacle is the United Auto Workers, which for decades has been demanding all sorts of benefits and salary requirements that made the Big Three much less competitive than their foreign or non-union counterparts. The average total cost of a unionized employee is over $70 an hour, while the total cost for a non-union autoworker is usually less than $50. If Michigan were a "Right to Work" state, where each worker would be able to choose whether or not to join the union, the union would not have had as much clout and the discrepancy would not have been as great. But because the federal labor laws make union membership in a union shop compulsory (except when a state opts out via "Right to Work" legislation), the UAW was in effect able to exercise monopoly control of the workforce to win concessions that have not only damaged the Michigan-based automakers' ability to compete, but have ultimately put the workers' jobs in jeopardy.

In the past, the American auto giants could just pass all the added expenses on to the consumer, but with competition in the industry becoming increasingly more fierce and international, contracts that were agreed to in better years seem to be unsustainable if the Big Three hope to remain competitive.

Government regulation and taxation have also harmed the automobile companies (as they have the entire economy). GM paid $37 billion in taxes in 2007. Foreign competitors pay what's called a Value Added Tax (VAT) on each vehicle sold, which works against the American companies. For instance, German car companies pay a 19-percent VAT, but this entire tax is reimbursed to the companies if they export the vehicle (no tax). If an American car is sold in Germany, the VAT gets added to the American car, making it hard for American companies to compete overseas. Those are just the federal tax problems. The Tax Foundation rates Michigan's corporate tax structure as the worst in the nation. Additionally, the current financial meltdown has contributed to the sales slump and compounded the problem of paying off huge debts.

GM, which the *Detroit News* reported spent $17 million on Viagra in 2006, is on the hook for at least $45 billion to its creditors according to its quarterly report filed with the Securities and Exchange Commission. It also must fork over more than $7.5 billion early in 2010 to a UAW-administered healthcare fund for retirees. Ford owes its creditors more than $26 billion and must also pay in $6.3 billion to the UAW trust fund. The financial data for Chrysler is not available since it is not a publicly traded company, but Chief Executive Officer Robert Nardelli said it will be difficult for the company to survive without government help.

The three automakers collectively spent $18 billion of their reserves just in the last quarter. In short, their business models are not working, and since Americans won't give them money voluntarily for their products (at least not at the prices those products are being sold for), plan B seems to be to take that money by force via the bailout. While Ford says it may be able to make it until 2010 without government money, GM and Chrysler have indicated that they could collapse within weeks if the federal government doesn't step in and throw them a lifeline.

Made in China

Of course, the Big Three automakers are claiming that the companies are too big to be allowed to fail, and they are predicting the doom of the American economy in the absence of a government rescue plan.

Some estimates claim that the demise of the Big Three could mean the loss of over two million jobs if all of the other industries connected to the automakers are included. But with four percent of GDP and one in every 10 jobs in the United States being auto-related, the Center for Automotive Research put the figure closer to three million lost jobs. Experts are predicting that if such a collapse were to occur, unemployment could jump by up to 10 percent, meaning declining revenues for the government, which would presumably then be expected to pay unemployment benefits. UAW president Ron Gettelfinger testified before Congress that "the stark reality is that these companies would be forced into a Chapter 7 liquidation, with their operations ceasing entirely and their assets sold for pennies on the dollar."

Who would buy up the Big Three's assets? One possibility, which has received scant attention, is the Chinese. The *21st Century Business Herald*, one of China's leading business newspapers, reported that carmakers Shanghai Automotive Industry Corporation and Dongfeng Motor Corporation have plans to acquire GM and Chrysler. The article quoted a senior official in China's Ministry of Industry and Information as saying that the Chinese companies "have the capability and intention to buy some assets of the two crisis-plagued American automakers." The report speculated that the move would be a good fit with China's plans. "It would be much easier now for strong Chinese automakers to go global by acquiring some assets of their U.S. counterparts in times of crisis." With 70 percent of Dongfeng (a company founded at the request of Mao Zedong in 1968) reportedly owned by the Chinese government, which has over $2 trillion (U.S.) in reserves, America's cars could soon read "made in China," assuming the communist nation will keep lending Americans money to buy them. It would be far easier for the Chinese to enter the global auto market with well-known and established brands and technology purchased from the United States, so the move would make sense from the Chinese government's perspective.

Obviously a sale to hostile foreign interests could be blocked. But could the automakers continue doing business after declaring bankruptcy? According to company executives that is "not an option" since, they claim, nobody would buy a car from a bankrupt firm. "There isn't a plan B," said Fritz Henderson, GM's Chief Operating Officer. "Absent support, frankly, the company just can't fund its operations." Chrysler's CEO indicated that without the bailout, America could be headed for, "God forbid," a depression.

But while corporate and union executives predict the demise of the industry and more dire news for the economy if they have to file for bankruptcy, others with direct knowledge of the industry say that bankruptcy may be the only way to save the industry. Former Republican presidential candidate Mitt Romney, whose father remarkably resuscitated American Motors from the brink of collapse in the 1950s, blasted the bailout in an editorial written for the *New York Times* entitled "Let Detroit Go Bankrupt." According to Romney: "A managed bankruptcy may be the only path to the fundamental restructuring the industry needs. It would permit the companies to shed excess labor, pension and real estate costs." He argues that a bailout will seal their fate and simply allow them to continue down the road to failure on which they currently find themselves, postponing the inevitable for a little while longer. Many analysts point to past bankruptcies in the airline industry as a precedent for successful reorganization of large corporations.

Hat in Hand

Having rejected managed bankruptcy as an option, the executives from the Big Three auto companies have gone to Congress hat in hand. After being sent away from their first visit empty-handed, they returned on December 2 with their plans, and this time they didn't show up in the private jets that had caused such a stir in November — they arrived instead in hybrid cars.

Legislators told them to show how the companies would survive and pay back the money. Some concessions have already been agreed to, including UAW's announcement that it would allow a delay in contributions to the medical funds and even suspend a program that pays laid-off union workers up to 95 percent of their regular pay. The companies themselves have agreed to some sacrifices in exchange for tax dollars too. Ford and GM's CEOs said they would cut their pay to $1 per year, which Chrysler's CEO has already done. Of course, they'll undoubtedly still get stock options worth millions, whether the companies stay in business or sell to the Chinese. Ford also offered to cancel management bonuses, cut executive pay, and suspend merit raises for salaried employees next year. Ford and GM have both agreed to sell off the companies' private jets, while Chrysler is set to slash employee benefits. All three will be closing plants, shedding tens of thousands of workers and shutting dealerships across the nation to help reduce expenses. All of the plans also include provisions to give the government a stake in the companies, furthering the trend of government control over private businesses. But if the new business plans made economic sense and would actually fix the problems and turn a profit, wouldn't investors and creditors be willing to jump in?

Democratic congressional leaders including Nevada Senator Harry Reid and House Speaker Nancy

Pelosi both support a bailout. "We have to make sure we do everything we can to take care of the auto industry," Reid said.

Senator Jim DeMint (R-S.C.) disagrees. "Some auto manufacturers are struggling because of a bad business structure with high unionized labor costs and burdensome federal regulations," said DeMint. "Taxpayers did not create these problems and they should not be forced to pay for them."

Senator John Ensign commented as well: "We are in the midst of a recession, yet we have come back for a late session of Congress to talk about saving just three companies. Why aren't we considering pro-growth policies to help the larger economy? We should be considering long-term, pro-growth tax cuts rather than searching for ways to spend more of the taxpayers' money. For instance, lowering the corporate tax rate would put more money back in the hands of companies all across America. This would help companies stay afloat and to avoid cutting jobs during these difficult times."

Congressman Ron Paul (R-Texas) also opposes the bailout. "Back in 1979 Congress had hearings about bailing out Chrysler and I was on record pointing out that these types of policies are foolish and very damaging to the long-term economic health of our country. They still are," wrote Ron Paul in a recent column entitled "The Bailout Surge." "It is obvious to most Americans that we need to reject corporate cronyism, and allow the natural regulations and incentives of the free market to pick the winners and losers in our economy, not the whims of bureaucrats and politicians."

Congressman Tom Price (R-Ga.) also said he is still firmly against the bailout and that his constituents are backing him up. "All they see is the government printing money and obligating their children and grandchildren to a greater debt," he said. But Nancy Pelosi is determined: "I believe that an intervention will happen. It's pretty clear that bankruptcy is not an option."

Congressmen opposing the bailout are out of step both with the GOP and Democratic congressional leadership, as well as with the Bush administration. But considering that the Big Three spent almost $50 million lobbying this year, the support by leadership in government for a bailout shouldn't be a surprise. At press time the initial bailout of $14 billion was blocked by Senate Republicans after passing in the House. President Bush is now weighing different options to get the auto makers the cash, which could come from the Federal Reserve or the $700 billion Troubled Asset Relief Program fund originally intended for banks. He indicated that it would not be long before a solution was agreed to.

Constitutional Solutions

But much more than merely "bailing out" the auto industry is involved. Testifying before Congress during the auto industry hearings in November, University of Maryland business professor Peter Morici put it bluntly: "This is not a bailout, this is going to be a slow-motion nationalization. If you give them money today, you'll give them money tomorrow and forever after that."

Printing more Federal Reserve Notes and confiscating more wealth from Americans to give to private companies in violation of the Constitution is not a real solution to anything. Nor is government ownership of industry. There are plenty of ways the government could constitutionally help the automakers and the economy as a whole — lowering taxes, lessening the regulatory burden, ending compulsory union membership, and allowing the free market to work would be a good start.

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