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Putting the Brakes on the Automaker Bailout

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Nothing gathers a crowd in Washington like the sight of money being handed out. Thus, in the wake of this weekend's federal takeover of Freddie Mac and Fannie Mae, automobile manufacturers in the United States were requesting help from the government as well. The Big Three—General Motors, Ford and Chrysler—are asking for $50 billion in low-interest federal loans to develop alternatives to conventional fossil fuel powered vehicles.

The idea has garnered surprisingly broad support: Both Barack Obama and John McCain have both expressed their support for federal assistance to the industry, which is based in the critical swing state of Michigan. (Ralph Nader, meanwhile—who made his reputation as an anti-Detroit crusader—is opposing the move.)

Detroit is unlikely to get the full $50 billion they want. But congressional leaders are moving quickly to get $25 billion—the amount provided for, but not finalized, in energy legislation last year—out the door. The most likely vehicle is the economic stimulus bill now being crafted by Congress.

The proposed bailout, however, would do little to solve the very real long-term problems of the U.S. automobile industry, which include not just fuel inefficiency but large retirement, health, and other costs. Meanwhile, American taxpayers would be left to pay the tab for years of bad business decisions by Detroit. And the cost is unlikely to end there. If Detroit receives a federal handout, more industries would come for their own dollop of aid.

More Fuel Efficient Cars. The Energy Independence and Security Act of 2007, signed into law by President Bush last December, provided for $25 billion in federal loans for automobile manufacturers to develop more efficient and cleaner vehicles,[1] as well as loan guarantees and direct grants. Priority would be given to investments in older plants in the U.S., in effect ensuring that the aid goes to Ford, General Motors, and Chrysler rather than foreign-based firms that also build cars in the U.S., such as Toyota. Congress, however, did not appropriate the $3.75 billion necessary to implement the loan program.

Supporters of federal aid say that the aid is necessary for them to finance a shift to more efficient vehicles. High gasoline prices have driven consumers away from purchasing trucks, sport utility vehicles (SUVs), and minivans.

But why should taxpayers be asked to pay for this change of business model? Detroit's dependence on big, non-fuel efficient vehicles was its own doing. The strategy, not shared by rivals such as Toyota, was long a profitable one; for many years SUVs and minivans were a golden goose for the Big Three. But now this strategy is proving costly.

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Moreover, not all of Detroit's current woes are due to the lack of energy-efficient cars; high retirement and other labor costs may be more to blame. In any case, there is no reason taxpayers should bear the cost of the Big Three's business decisions.

Not a Subsidy? But, say the automakers, the loans are not a subsidy, since the manufacturers would be expected to pay the money back. This is nonsense: Such loans come at a cost to taxpayers, both explicitly and implicitly, to cover the risk of default. The auto industry's claim to the contrary, in fact, is disturbingly similar to claims long made by Fannie Mae and Freddie Mac that their implicit federal guarantee did not impose costs on the federal treasury. That implicit guarantee is now costing taxpayers billions in very explicit dollars.

The proposed deal for taxpayers, in fact, is in one sense worse than that shouldered by the taxpayers 25 years ago when the federal government bailed out the Chrysler Corporation. At that time, the federal government assumed ownership of Chrysler shares, providing them with a benefit if the firm did well. This time around, there is no upside potential for gain for taxpayers but only a downside risk of loss.

But, some say, the auto firms are "too big to fail." Like Freddie and Fannie, they argue, their bankruptcy would throw the U.S. economy into chaos.

Regardless of whether such an assertion holds true for Freddie Mac and Fannie Mae,[2] that argument simply does not hold water for the auto industry. Simply put, the U.S. economy is not dependent upon the success or failure of the auto industry, especially not solely the Big Three. Not only are the Big Three a smaller portion of the auto market than a generation ago, but even in the event of bankruptcy, their assets would not simply disappear. Manufacturing—and jobs—would largely continue, while the affairs of the companies were reordered to make the firms once again viable. In fact, in many cases, such a process is necessary to the revival of an industry. Short-term aid could end up merely delaying such restructuring, prolonging the troubles of the industry.

A Slippery Slope. A bailout would also set a disturbing precedent, resulting in even more private companies clamoring for government sponsorships.

A number of companies today could make the case that their respective industry is vital for the economy and begin requesting billions of dollars in bailout subsidies. There has already been talk of bailout requests from the airline industry. More will surely follow.[3]

Having the government, and ultimately the taxpayer, finance a transition to more fuel efficient cars is simply bad policy rooted in election-year politics. Policymakers should slam on the brakes to avoid this hazard.

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1. Energy Independence and Security Act of 2007, Public Law 110-140, at *http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h6enr.txt.pdf* (September 9, 2008).
2. See, J. D. Foster, Ph.D., David C. John, and Stephen A. Keen, "Fannie and Freddie: Time to Clean up the Mess and Move Forward," Heritage Foundation *WebMemo* No. 2055, September 9, 2008, at *http://www.heritage.org/Research/Economy/HousingandFinancialMarkets/wm2055.cfm*.
3. See Nelson D. Schwartz, "Who Else Can Pile On for a Federal Rescue?" *The New York Times*, Sept. 8, 2008, at *http://www.nytimes.com/2008/09/09/business/09big.html?em* (September 11, 2009).