WebMemo
Published by The Heritage Foundation

No. 2163
December 9, 2008

Saving Detroit Automakers with an Advance Purchase of Cars and Trucks

Ronald D. Utt, Ph.D.

After several days of negotiation, the President and the leadership of Congress are closing in on an agreement to bailout the indigenous automobile manufacturers with a loan that may be as high as $15 billion. Details are still fluid as the final agreement is hammered out, but under the President's initial proposal, a "car czar" would be tasked with overseeing the industry's recovery, while early reports on the congressional plan suggest that Senator Christopher Dodd (D–CT)—who, as chairman of the Senate Banking Committee, most recently oversaw the diminution and nationalization of Fannie Mae and Freddie Mac—expects to lead the reformation of General Motors, Chrysler, and Ford.

Dodd has already announced his intention to influence company personnel decisions, while others in Congress, notably Senator Chuck Schumer (D–NY), expect to guide the industry's future product selection and development.

It is essential that any bailout plan be structured to limit the damage that unqualified bureaucrats and elected officials might inflict on the companies while at the same time better protecting the taxpayers' investment in the struggling industry. And while a bankruptcy filing is still the best bet for fundamental reform, if Congress and the President insist on "helping" Detroit, the better bet for short-term relief is not a federal loan but an advance cash purchase by the federal government of some dollar volume of cars and light trucks manufactured by the American companies. With current federal car purchases amounting to about $1.3 billion per year,[1] an advance payment for a seven-year supply would provide the manufacturers with nearly $10 billion in liquidity.

A Bailout Without a Bailout. Although an emergency loan of some sort and of some magnitude seems to be the relief mechanism of choice, the desperate financial conditions confronting the companies (at least as described by their leaders) suggest that any extension of credit will not likely be paid back any time soon and that more federal financial relief will soon be required to keep them afloat. Under these circumstances, the federal government will become more of a reluctant partner than a creditor, and as the industry's difficulties persist and worsen in the weak market that most expect for 2009, the car companies and many in Congress will more than likely urge another massive federal loan in order to protect the first one, as the industry again threatens collapse.

A better mechanism would be for the federal government to instead agree to an advance cash purchase of some dollar volume of cars and trucks manufactured by the troubled indigenous car manufacturers. Inasmuch as the federal government is already a major buyer of U.S.-made autos and trucks, the federal government could make an

This paper, in its entirety, can be found at:
www.heritage.org/Research/Economy/wm2163.cfm

Produced by the Thomas A. Roe Institute
for Economic Policy Studies

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

advance cash purchase of cars and trucks to the tune of, say, $10 billion (divvied up in proportion to company market share) at a price per vehicle of, say, 5 percent below fleet price (i.e., the volume discounts provided to major car rental companies) at time of purchase. Moreover, the purchase contract should be structured to be senior to any other company financial obligation in the event of a liquidation or bankruptcy. After some interval (say, three years), the federal government would have the option of selling any remaining car purchase entitlements to any buyer at a price of its choosing.

Advantages of an Advance Cash Purchase. In comparison to current loan proposals, an advance purchase program has several advantages:

- Unlike a loan, the advance cash purchase program is self-amortizing and will begin the "principal" payback process with the first federal purchase of a car or truck made by Ford, General Motors, or Chrysler.
- "Collateral" for the "debt" is easily identified and secured, even in the event of bankruptcy.
- Unlike a loan, the purchase agreement would keep the taxpayers' commitment at a safe distance from the industry's problems and would lessen the prospect of being dragged in deeper if financial problems worsen.
- It keeps the industry free of counter-productive interference in business decisions by unqualified bureaucrats, elected officials, and congressional staff. It would be more difficult for Congress to add strings that may require investment and production decisions to encourage the manufacture of cars that no one will buy and in products where U.S. companies have no comparative advantage.
- It will not set another open-ended precedent for loan/investment support that other industries may seek as economic distress spreads with the worsening recession.

Better Than a Loan. While the best course of action would still be a bankruptcy filing, in the event that the President and Congress remain committed to a massive and costly financial bailout, an advance cash purchase contract would be superior to a loan.

With an advance purchase contract as the means of providing liquidity to the indigenous automobile and light-truck industry, a tougher precedent (with greater prospect of recovery) would also be established and would help deter other industries from seeking generous taxpayer bailouts.

It may also provide an alternative to a problematic Administration/congressional bailout that many members would feel compelled to support, since there would be no other option beyond the threat of wholesale financial collapse. An advance purchase plan would avoid these problems and better secure the taxpayers' position than any of the other options.

—Ronald D. Utt, Ph.D., is Herbert and Joyce Morgan Senior Research Fellow in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

1. U.S. General Services Administration, Office of Governmentwide Policy, *Federal Fleet Report, Fiscal Year 2007*, January 2008, Table 2-9: GSA Vehicle Procurement, p. 34, at *http://www.gsa.gov/graphics/ogp/FFR2007_508.pdf* (December 8, 2008).