

# Background

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## Closing Car Dealerships: A Matter of Economics, Not Politics

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In May, as part of their reorganization in bankruptcy, both Chrysler and General Motors announced that they would terminate their contracts with many of the local auto dealers who sell their cars. Chrysler terminated nearly 800 dealers the next month, while GM informed 1,100 dealers that their contracts would end next year.

The decisions set off a firestorm of protests from dealers, who argued that the terminations were unnecessary. Going further, some commentators charged that the terminations were politically motivated by the Obama Administration, which allegedly pressured the automakers to target dealerships for termination more for their partisan affiliation than for economic performance.

Several proposals are now pending in Congress to limit these terminations, including the Automobile Dealer Economic Rights Restoration Act of 2009 (H.R. 2743) by Representative Dan Maffei (D-NY), which would restore to dealers contractual rights lost in bankruptcy.

Sympathy for terminated dealers—many of whom have been in business for a generation or more—is understandable. Nevertheless, the terminations were essential steps toward returning GM and Chrysler to viability. And while the reorganization process for these two firms has been heavily politicized in many ways, research by The Heritage Foundation shows no evidence that the dealership termination process was influenced by partisanship. Absent such evidence, Congress should not interfere

### Talking Points

- Sympathy for terminated dealers is understandable. Nevertheless, the terminations were essential steps toward returning GM and Chrysler to viability.
- Analysts have long recognized that the Detroit-based automakers have an outsized dealer network.
- GM estimates that it will save some \$2 million for each dealer closed.
- Clearing away unsustainable obligations is exactly what the bankruptcy process was designed to do.
- Since dealerships gave more to Republicans overall, it is unsurprising that far more dealerships that gave to GOP candidates closed than those whose owners gave to Democratic candidates.
- Evidence does not suggest that the bankruptcy process was used to terminate dealerships owned by generous Republican supporters.
- The danger of political interference comes not from the selection procedure but from efforts in Congress and elsewhere to overturn the choices made by the automakers that they hope will return them to viability.

This paper, in its entirety, can be found at:  
[www.heritage.org/Research/Economy/bg2296.cfm](http://www.heritage.org/Research/Economy/bg2296.cfm)

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with these painful but necessary moves to bring GM and Chrysler back to profitability.

## Too Many Dealers

Analysts have long recognized that the Detroit-based automakers have an outsized dealer network. The excess dealerships are in part a legacy of earlier times, when Detroit sold many more cars than today, and in part the result of demographic and business changes that have made fewer dealers necessary. For years, Detroit automakers have slowly trimmed their networks, but progress has been slow—in no small part due to state franchise laws that made termination difficult.<sup>1</sup> As a result, GM has some 6,000 dealers nationwide, and Chrysler (before terminations) had over 3,000 dealers. Toyota, by contrast, has only 1,240 dealerships. Altogether, GM and Chrysler dealers sold 497 and 475 cars per dealer, respectively, in 2008, while the average Toyota dealer saw off 875 cars.<sup>2</sup>

This surplus of dealerships hurt the manufacturers in several ways. First, although the dealerships are owned independently, they receive financial support from GM and Chrysler through a variety of mechanisms, ranging from low-cost financing for vehicles in inventory to local advertising assistance. GM estimates that it will save some \$2 million in such costs for each dealer closed.<sup>3</sup>

Second, and perhaps even more significantly, a surplus of franchises means dealers for the same manufacturer end up competing among themselves, resulting in lower returns across the board. With less revenue, not only do dealers need more assistance from the manufacturer, but they find it harder to maintain service and quality levels.

But even though the terminations were justified, some critics argue that the process was unfair, using

bankruptcy to deprive dealers of contractual rights as well as overriding state laws granting auto dealers special protections against closures. But clearing away unsustainable obligations is exactly what the bankruptcy process was designed to do.

## Political Bias?

Of more concern are claims that the decision as to which dealers were terminated was itself skewed so that Republican-leaning dealers were treated more harshly than those that supported Democrats. This is a serious charge. From the beginning, the GM and Chrysler bankruptcies have been dominated by the federal government—which is taking a stake in both firms—and many decisions have been politically tinged.<sup>4</sup> But is there evidence that the dealership termination lists were politically biased?

To examine the issue, The Heritage Foundation identified the 789 Chrysler dealerships that were closed and the 2,392 dealerships that will remain open and affiliated with the manufacturer. This information is contained in the bankruptcy papers of Chrysler's Chapter 11 filing, filed with the United States Bankruptcy Court for the Southern District of New York. These documents contained dealership names and addresses, as well as the identity of the majority owner of the dealership.

The Heritage Foundation then collected data on the political contributions made by the majority owner of each dealership. The name of each dealership's majority owner was compared to the donor database maintained by the Center for Responsive Politics.<sup>5</sup> This database includes all available Federal Election Commission data. The Heritage Foundation collected data on how much money the majority owner donated to the McCain and Obama campaigns in the 2008 election cycle as well as all

1. See Robert D. Atkinson and Mark Cooper, "Ailing Auto Industry: A Cure by Way of the Consumer," *The Washington Times*, December 17, 2008, at <http://www.washingtontimes.com/news/2008/dec/17/ailing-auto-industry> (July 8, 2009).
2. "Detroit 3 Sales per Dealer Decline in '08," *Autonet.ca*, January 13, 2009, at <http://www.autonet.ca/autos/news/2009/01/13/8012966-cp.html> (July 8, 2009).
3. Frederick A. Henderson, testimony before the Subcommittee for Oversight and Investigations, Committee on Energy and Commerce, U.S. House of Representatives, June 12, 2009.
4. See James Gattuso, "Chrysler's Creditors and Offers You Can't Refuse," *The Foundry*, May 1, 2009, at <http://blog.heritage.org/2009/05/01/chryslers-creditors-and-offers-you-cant-refuse>.
5. Center for Responsive Politics, at [www.opensecrets.org](http://www.opensecrets.org) (July 8, 2009).

donations made to federal GOP and Democratic candidates in the 1990–2008 election cycles.

Table 1 shows summary statistics on dealer closings and political donations.<sup>6</sup> Dealerships whose owners donated to federal political campaigns are classified as McCain donors, Obama donors, Republican donors, Democratic donors, and donors to both parties. The appendix explains the details of these classifications.

Roughly a third of all dealerships are owned by individuals who gave money to political candidates, and these donations tilted heavily toward Republican candidates. Chrysler dealership owners gave a total of \$1,347,637 to Democratic candidates and \$6,989,079 to Republican candidates over the period studied. Since dealerships gave more to Republicans overall, it is unsurprising that far more dealerships that gave to GOP candidates closed than those whose owners gave to Democratic candidates. About 130 GOP-donor-owned dealerships closed, compared to 25 Democratic-donor-owned dealerships and 77 dealerships whose owners gave to both parties.

Analyzing dealership closure rates reveals whether dealerships owned by McCain or Obama supporters were more or less likely to close than those owned by non-donors. In fact, dealership closure rates differ little by political donation status. Twenty-five percent of all Chrysler dealerships were closed in the bankruptcy proceedings. Dealerships owned by McCain donors were not statistically significantly more or less likely to close than dealerships whose owners did not give to McCain. The same is true of dealerships owned by Obama donors and dealerships whose owners gave to both parties.

### Auto Dealership Closure Rates by Political Donations

	Total	Dealership Status		% Closed
		Closed	Open	
All dealerships	3,181	789	2,392	24.8%
McCain-only donors	52	14	38	26.9%
Obama-only donors	9	2	7	22.2%
GOP-only donors	603	131	472	21.7%*
Democratic-only donors	135	25	110	18.5%*
Donors to both parties	283	77	206	27.2%

\* Indicates statistically significant different closure rates than non-donors.

Source: Heritage Foundation calculations based on data from the Center for Responsive Politics, at <http://www.opensecrets.org> (July 8, 2009).

Table 1 • B 2296  [heritage.org](http://heritage.org)

Dealerships whose owners gave primarily to Republican candidates closed at statistically significantly lower rates than dealerships whose owners did not, and the same was true of dealerships owned by Democratic donors.<sup>7</sup> Only 22 percent of GOP-donor-owned dealerships and 19 percent of Democratic-donor-owned dealerships closed.

It is important to keep in mind that this correlation does not imply causation: It does not follow that the Obama Administration used its influence to keep dealerships owned by Republican and Democratic donors open. More likely, owners of more financially stable dealerships have higher incomes and are more likely to give to political candidates. At the same time, these financially stable dealerships were less likely to be closed by bankruptcy proceedings.

Table 2 shows the average amount given by those dealership owners who donated to political candidates. The differences in donation levels between dealerships that closed and those that remained open are insignificant with one exception: Dealerships owned by Democratic donors

- The unit of observation is the individual dealership, not the dealership owner. If the owner of three dealerships gave \$1,500 to the McCain campaign and nothing to Democratic candidates, then that appears in this table as three McCain/GOP donor dealerships, not as one dealership owner.
- A two-sided T-test rejects the null hypothesis that GOP-donor-owned dealerships are just as likely to close as those not owned by GOP donors at the 5 percent level. The null hypothesis that Democratic donor owned dealerships are as likely to close as non-donors is rejected at the 8 percent level.

## Average Political Donations from Auto Dealers

	Dealership Status		All Dealerships
	Closed	Open	
McCain donors to McCain	\$1,411.07	\$1,671.05	\$1,601.58
Obama donors to Obama	\$225.00	\$1,178.57	\$966.67
GOP donors to all GOP candidates	\$7,649.41	\$9,934.02	\$9,437.70
Democratic donors to all Democratic candidates	\$5,519.56	\$2,750.99	\$3,263.69*
Donors to both parties/candidates to all candidates	\$28,045.23	\$25,006.83	\$25,833.53

\* Indicates statistically significant difference between average amount donated by closed dealerships and those that remained open.

Source: Heritage Foundation calculations based on data from the Center for Responsive Politics, at <http://www.opensecrets.org> (July 8, 2009).

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that closed gave significantly more money to Democratic candidates than those that remained open.<sup>8</sup> GOP-supporting dealerships that closed did not give more money to Republican candidates than those that remained open. Evidence does not suggest that the bankruptcy process was used to terminate dealerships owned by generous Republican supporters.

## No Correlation

The correlations between donor status and dealership closing can be analyzed more thoroughly with regression analysis. The Heritage Foundation used two probit regression models for this purpose. The first regresses dummy variables indicating whether an individual dealership's owner gave to the McCain and Obama campaigns and whether it gave to both GOP and Democratic candidates on a dummy variable indicating if the dealership closed or not. The second adds the total amount given to GOP and Democratic candidates to this base model.

8. The difference is significant at the 0.4 percent level.

Table 3 shows the results of both models, both of which have little explanatory power. Model 1 shows that whether a dealership's owner contributed to McCain, Obama, or candidates of both parties has no statistically significant correlation with whether it closed, although dealerships owned by GOP and Democratic donors were slightly more likely to remain open.

The second model in the second column incorporates the total donations given to both GOP and Democratic candidates. The total amount that dealerships gave to either party's candidates has no explanatory power, and the first model's results remain largely unchanged. GOP- and Democratic-donor-owned dealerships remained slightly less likely to

## Probit Regressions on the Probability of a Dealership Closing and Dealer Owners' Political Donations

Number of observations: 3,181

	Model 1		Model 2	
	Coefficient	Robust Standard Error	Coefficient	Robust Standard Error
McCain donor	0.1740	0.1948	0.1914	0.2012
Obama donor	0.0246	0.4598	0.0165	0.4613
GOP donor	-0.1450	0.0667*	-0.1426	0.0669*
Democratic donor	-0.2451	0.1315**	-0.2601	0.1317*
Donor to both parties	0.0451	0.0849	0.0195	0.0991
Total donated to GOP candidates (in thousands of dollars)			-0.0004	0.0009
Total donated to Democratic candidates (in thousands of dollars)			0.0043	0.0061
Constant	-0.6516	0.0291	-0.6516	0.0291
Log pseudo-likelihood	-1,777.4587		-1,777.173	

\* Statistically significant at the 5% level.

\*\* Statistically significant at the 10% level.

Source: Heritage Foundation calculations based on data from the Center for Responsive Politics, at <http://www.opensecrets.org> (July 8, 2009).

Table 3 • B 2296 [heritage.org](http://heritage.org)

close than non-donors, confirming the earlier analysis of closing probabilities.<sup>9</sup>

### The Real Danger

The bankruptcy process is intended to provide failing firms with both the incentive and ability to make their enterprises viable. In regard to dealer terminations, the process seems to have worked the way it was supposed to—with General Motors and Chrysler shrinking dealer networks, thereby confronting a problem that had long been known and which they had previously been unable to address adequately.

Political interference in this process, or any process so dominated by the government, is of course

always a concern. In this case, however, claims that the method by which dealers were selected was biased appear to be unfounded, with no correlation between political contributions and terminations. Instead, the real danger of interference comes from efforts in Congress and elsewhere to overturn these painful but economically necessary choices made in the hopes of returning automakers to profitability.

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9. The marginal effects are small. GOP-donor-owned dealerships are 4 percent less likely to close than non-GOP-donors, and Democratic-donor-owned dealerships are 8 percent less likely to close than non-donors.

## APPENDIX DONOR CLASSIFICATION

For the purposes of this study, a McCain donor is a dealership whose majority owner donated to the John McCain for President Campaign in 2008, gave less than \$500 to Democratic candidates in all election cycles, and gave more to the McCain campaign than to all Democratic campaigns. An Obama donor gave at least \$500 to the Barack Obama campaign, gave less than \$500 to Republican candidates in all election cycles, and gave more to Obama than to past Republican candidates. Democratic donors gave at least \$500 to Democratic candidates and less than \$500 to GOP candidates, while GOP donors gave at least \$500 to Republican candidates and less

than \$500 to Democratic candidates. Dealerships classified as donating to both parties gave at least \$500 to Republican and Democratic candidates over all election cycles.

Note that McCain and GOP-donor-owned dealerships are not mutually exclusive categories. Any dealership whose owner gave less than \$500 to Democratic candidates and more than \$500 to the McCain campaign would be classified as both a McCain donor and a Republican donor. Similarly, Obama donors and Democratic donors are not mutually exclusive.