WebMemo
Published by The Heritage Foundation
No. 2306
February 20, 2009

Another Bailout for Detroit Automakers Would Throw Good Money After Bad

Nicolas D. Loris

This week, General Motors and Chrysler returned to Washington with their reorganization plans to allegedly put them on a path toward long-term sustainability. The stunning part of the plan was their double-down request for nearly $22 billion in additional loans, making it even clearer they are unlikely to pay back the taxpayer.

These plans were required as a condition of their $17.4 billion in bailout loans last December. With the $39.4 billion in loans to GM and Chrysler, the auto suppliers asking for $25.5 billion, and the $25 billion in federal loans for automobile manufacturers to develop more efficient and cleaner vehicles, the total comes to $97.4 billion.

While the problems of GM and Chrysler have certainly been exacerbated by the economic downturn and the credit crunch, they have been hampered by long-term problems such as high labor costs, legacy costs, and inefficient dealer networks.[1] Using taxpayer money to bail out Detroit was not a good idea in the first place, and nothing has changed to make it a good idea now; Congress should not throw good money after bad. Bankruptcy remains the better option—for taxpayers and for the automakers themselves.

Poor Sales Numbers. There is little doubt that auto manufacturers—or at least some of them—are in real trouble. For the month of January, GM's sales plunged 49 percent, and Chrysler's fell 55 percent. Non-Detroit companies did not perform much better: Toyota's sales dropped 32 percent, Nissan's 30 percent, and Honda's 28 percent. Only two companies posting sales numbers in the green: Subaru with an 8 percent sales increase and Hyundai with a 14 percent sales increase.[2]

In a recessionary environment, there is no indication that sales will increase any time soon for GM and Chrysler. Having the government prop up a failing industry does not signal to consumers that these two companies are on the road to recovery. In reality, few people fail to recognize that GM and Chrysler are in very serious trouble—auto firms have hardly kept their woes a secret. Moreover, the companies' plans for long-term viability do nothing to assuage that recognition. Senator Richard Shelby (R–AL) recently remarked, "The plans fail to demonstrate that either GM or Chrysler can reduce its labor costs to match its competitors. They also fail to show that the companies can reverse the decades-long slide in their market share."[3]

The Plans: More Money, Optimistic, and Incomplete. GM was asked to include baseline, upside, and downside scenarios in its plan, and given current economic conditions, the downside scenario will be closest to reality. This scenario calls for $16.6 billion in taxpayer-funded loans, which

This paper, in its entirety, can be found at:
www.heritage.org/Research/Economy/wm2306.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

The Heritage Foundation
LEADERSHIP FOR AMERICA

would bring the total to over $30 billion (counting the bailout from last December). In addition to asking the U.S. government for money, GM is also requesting $6 billion in loans from foreign governments. They plan to cut 47,000 jobs while focusing solely on the Chevrolet, Cadillac, Buick, and GMC brands. All new models will be high-mileage cars and crossovers, and they plan to recommit to hybrids, fuel efficiency, and advanced propulsion. In order to achieve sustainable profitability in two years, they plan to phase out Hummer, Saab, and Saturn.[4]

Chrysler is requesting an additional $5 billion from the government in their plan, bringing the total that Congress has "loaned" the company to $9 billion. The company plans to reduce jobs by 3,000, cut factory capacity, and remove the Chrysler Aspen, Dodge Durango, and Chrysler PT Cruiser models from their line. Chrysler also hopes to be at the forefront in terms of fuel efficiency, low emissions, and electric car development and commercialization. Chrysler maintained that a partnership with GM is one of the company's available options.[5]

Both plans, however, are incomplete. GM and Chrysler have until the end of March to reach agreements with the United Auto Workers and bondholders to cut costs. The Presidential Task Force on Autos, led by Treasury Secretary Timothy Geithner and National Economic Council Director Lawrence Summers, will begin reviewing the plans immediately.

Bankruptcy: Still the Best Option. GM has claimed that even a structured bankruptcy could ostensibly cost the taxpayers approximately $100 billion for payouts for pension plans. Some, however, have called GM's use of the $100 billion figure a scare tactic, and bankruptcy expert and New York University business professor Edward I. Altman conjectured that it could simply be part of GM's strategy not to be forced into bankruptcy.[6]

The bankruptcy process is often the best way for troubled enterprises to get back on their feet. Debts are reduced or cancelled and contracts terminated or renegotiated, allowing firms to get a fresh start. And if a firm still cannot be made viable, bankruptcy also provides for an orderly and predictable process for getting assets—including plants and equipment—back into productive use by others.

There are, of course, losers under bankruptcy. Management is more likely to be replaced, but that might be deserved. Shareholders lose their investment, but stock values are worth little already.

The most sweeping argument against bankruptcy is that millions of people employed by the automakers and by firms dependent on them will lose their jobs. The reality is just the opposite. The government should not prop up large, failing firms where consumers do not wish to purchase their products. The result would be sales lots full of GM and Chrysler cars and a loss of innovation and efficiency. Imagine if the government propped up the VCR industry while DVDs were available on the market.

Furthermore, bankruptcy does not mean an end to operations: Firms routinely continue operations while in the bankruptcy process. Moreover, even

1. See James Gattuso and Nicolas Loris, "The Detroit Bailout: Unsafe at Any Cost," Heritage Foundation *WebMemo* No. 2133, November 16, 2008, at *http://www.heritage.org/Research/Economy/wm2133.cfm*.
2. Kimberly S. Johnson and Bree Fowler, "Chrysler Sales Plunge 55 Pct; GM, Toyota Also Down," Associated Press, February 3, 2009, at *http://news.yahoo.com/s/ap/20090203/ap_on_bi_ge/auto_sales* (February 20, 2009).
3. John D. Stoll, "Sen. Shelby Says GM, Chrysler Viability Plans 'Fall Far Short,'" *The Wall Street Journal*, February 19, 2009, at *http://blogs.wsj.com/autoshow/2009/02/19/sen-shelby-says-gm-chrysler-viability-plans-fall-far-short/?mod=googlenews_wsj* (February 20, 2009).
4. General Motors Corporation 2009–2014 Restructuring Plan, February 17, 2009, at *http://treas.gov/initiatives/eesa/agreements/auto-reports/GMRestructuringPlan.pdf* (February 20, 2009).
5. Chrysler Restructuring Plan for Long-Term Viability, February 17, 2009, at *http://treas.gov/initiatives/eesa/agreements/auto-reports/ChryslerRestructuringPlan.pdf* (February 20, 2009).
6. Michael J. de la Merced, "Bankruptcy Could Be More Costly," *The New York Times*, February 19, 2009, at *http://www.nytimes.com/2009/02/19/business/19dip.html* (February 20, 2009).

the worst-case scenario—liquidation—does not mean vaporization. The assets of a firm do not vanish. Rather, they are resold to others more able to make productive use of them.[7]

Yes, jobs will be lost under bankruptcy, but these companies must become smaller to survive under any scenario—even with massive bailouts. In their bailout plans, for example, GM and Chrysler proposed to cut 50,000 jobs globally. If the companies were forced to address their problems and make the hard choices now—rather than postponing them through taxpayer bailouts—it will lead to more jobs and a better economy over the long term.

Sliding Down the Slippery Slope. Even if, as the automakers claim, bankruptcy would somehow cost taxpayers $100 billion—an unlikely scenario—the U.S. auto industry, including suppliers, propose government funding that totals $97.4 billion to get through the economic recession and transition to building more fuel efficient cars.[8] If the recession lasts longer than expected or consumers simply choose not to buy GM and Chrysler's cars, the $97.4 billion figure will likely grow larger. It is no surprise that GM and Chrysler are already asking for more money and it certainly will not be surprising if they come knocking back for more. But these bailouts provide no incentive to truly formulate a plan for long-term sustainability.

Even after $17.4 billion in loans, GM and Chrysler are still in trouble. While the current economic downturn has unquestionably exacerbated their problems, the crisis has been long in the making, fed by bad business decisions and failures to control costs. Congress correctly rejected the automakers' first request for government loans in December, but to the dismay of the nation, the Bush Administration conceded to Detroit's plea. Congress and the Obama Administration must stand strong and reject GM and Chrysler's attempt to extract more money from the taxpayer.

—Nicolas D. Loris is a Research Assistant in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

7. See Andrew M. Grossman, "Automakers Need Bankruptcy, Not Bailout," Heritage Foundation *Legal Memorandum* No. 33, November 15, 2008, at *http://www.heritage.org/Research/Economy/lm33.cfm.*
8. Justin Hyde, "Bottom Line: U.S. Auto Industry Says It Needs $97.4 Billion to Live," *Detroit Free Press*, February 19, 2009, at *http://www.freep.com/article/20090219/BUSINESS01/902190486/Bottom+line++U.S.+auto+industry+says+it+needs+$97.4+billion+to+live* (February 20, 2009).