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April Employment Report Showers Doubt on Detroit Bailout

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The April jobs report shows a labor market that continues to weaken. Employers shed another 611,000 private sector jobs, and the unemployment rate rose to 8.9 percent. These numbers indicate that the job market has not yet stabilized and that both job losses and rising unemployment will probably continue over the next six months.

These employment figures also demonstrate that this is the wrong time for the Administration's Detroit bailout strategy. The Obama Administration has used its clout to pressure many of Chrysler's creditors to take large losses on their holdings while protecting the United Auto Workers (UAW). This will make lenders reluctant to extend secured loans to other heavily unionized companies, further aggravating the problem of unionized companies losing more jobs than non-union companies because they invest less. The weak job market shows that this is no time to manipulate the financial system to reward politically favored interest groups.

April Jobs Numbers Grim. The April jobs numbers show the recession continues apace. Employers shed a net 539,000 jobs and the February, and March reports were revised to show the loss of another 66,000 jobs. The unemployment rate rose to 8.9 percent, and the median and average duration of unemployment both rose by over a week.

These are smaller job losses than occurred in recent months. However, private sector employers shed a net of 611,000 jobs—only slightly down from losses in February and March. Job losses appeared lighter because the government added 72,000 jobs, almost all of them in the federal government and most of those in preparation for the census of 2010. Spending by Congress and the Administration is creating more make-work government positions, but the productive private sector continues to contract.

Job losses were widespread throughout the private sector. The manufacturing (–149,000) and professional and business service (–122,000) sectors experienced the heaviest job losses. Those losses were heaviest in motor vehicles and parts manufacturing and temporary help services. The one almost bright spot was the health care sector, which experienced modest (17,000) job gains.

Creditors and Bankruptcy Law. As private sector job creation continues to weaken, the Obama Administration has controversially bailed out the Detroit automakers. Under federal law, creditors lend money on the condition that they can either sell assets belonging to the borrower or be first in line for repayment if the borrower defaults. In many cases, lenders would not loan money without these conditions. Mortgages work in a similar way: Banks would not lend hundreds of thousands of dollars to families to buy a house without the guarantee that, if they default, the bank can sell the house. Foreclosures are unpopular, but the fact that banks can

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foreclose enables families to take out a mortgage in the first place.

Similarly, creditors loaned money with the guarantee that if the business went under, they could be repaid ahead of other lenders or sell the remaining assets to recover their losses. The fact that General Motors and Chrysler could offer lenders this kind of assurance made it possible for them to borrow the money they needed to keep operating. Without collateral and priority status, the automakers would have gone out of business years ago.

White House Cramdown. In the Chrysler and GM bankruptcies, however, the Obama Administration is using its influence to reward political interest groups at the expense of secured creditors and the rule of law. The UAW is not a senior lender and does not have senior priority. Under bankruptcy law, they would stand in line behind more senior creditors, and the courts would probably eliminate most union work rules, above-market earnings, and retiree health benefits.

While the UAW does not have priority in repayment under bankruptcy law, it does wield considerable political influence. The Obama Administration's plan vaults the UAW to the front of the line while forcing lenders to take large losses in order to preserve a measure of the UAW's above-market earnings.

Under the Obama plan, the UAW agreed to some concessions at Chrysler—such as no overtime until employees put in 40 hours a week and consolidating some job classifications—as well as taking majority ownership of Chrysler in lieu of some contributions to the retiree health care fund. This plan was far more generous to the union than what a bankruptcy court would usually impose or allow. Under the Obama plan, lenders would get only 33 cents on the dollar for their debt—far less than they could expect in a normal bankruptcy.

The Obama Administration used its leverage with banks that loaned Chrysler money and also accepted TARP funding to persuade them to accept this unfavorable offer. A minority of creditors—primarily hedge funds that did not receive TARP funds—have insisted on their legal rights, and Chrysler has now filed for bankruptcy. The Obama Administration and Chrysler's management have used their leverage in the bankruptcy proceedings to largely proceed with the original plan.

Initial court rulings have gone against the creditors. While the bankruptcy proceedings are not complete, it appears likely that the final package will preserves a portion of the UAW's lucrative contracts while forcing creditors to take large losses. Bankruptcy at GM, if it occurs, is likely to proceed in a similar fashion.

Reduced Investment and Jobs in Unionized Companies. In the short term this clearly benefits the Detroit autoworkers: Many of them get to keep their jobs and their above-market wages. In the long term, however, this approach will cost jobs. It sets the dangerous precedent that the rule of law will be set aside when doing so benefits unions. Lenders will take this into account when extending loans to unionized companies, particularly companies with politically influential unions. Workers will always be more sympathetic than bankers. Forcing banks to the back of the line to help workers will usually make for good politics. Consequently, banks and other lenders will either charge higher interest rates to compensate for the risk of their legal rights being ignored or they will not make those loans at all. Because of this cramdown, unionized firms will have significantly more difficulty borrowing money—which, in turn, will cost jobs.

Unionized firms already invest significantly less than comparable non-union firms, and unionized firms tend to lose more jobs than non-union firms.[1] With less investment they have less of a competitive advantage. Being charged higher interest rates for having a union will exacerbate this problem. Unionized firms will invest even less, become less competitive, and lose more jobs because they will be able to borrow less money.

Recommendations to Congress. Private-sector job losses continued to mount in April, with employers shedding another 611,000 jobs and the unemployment rate rising to 8.9 percent. The economy cannot afford the Administration subverting the rule

1. Barry T. Hirsch, "What Do Unions Do for Economic Performance?" *Journal of Labor Research*, Vol. 25, No. 3, (July 2004) pp. 415–456.

of law and the financial markets to benefit politically favored interest groups. In the short term, this approach will preserve some union jobs with above-market wages. In the long term, however, creditors will not loan their money to companies if they do not expect to be repaid. This development will place unionized companies at a competitive disadvantage. Consequently, unionized firms will go out of business more frequently, and far more jobs will be lost.

Congress should intervene to stop this destructive policy by passing legislation that:

- Prevents the Administration from using TARP funds to pressure banks to extend loans to particular groups or to forgive certain debts; and
- Provides greater protections for creditors in bankruptcy proceedings to prevent such political abuses.

Such measures are essential to preventing an already weak job market from deteriorating further.

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