

# WebMemo



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## General Motors Bankruptcy and Nationalization: Exit Strategy Needed

*James L. Gattuso*

Congratulations: If you are a U.S. taxpayer, you will soon be a part owner of a car company.

Under the latest reorganization plan for General Motors, Uncle Sam would take ownership of 72.5 percent of the troubled automaker while providing an additional \$30 billion in funds to the company.

The proposed deal would give Washington controlling ownership of a major industrial corporation for the first time since Conrail railroad was sold in 1986. And, along with the pending acquisition of a minority stake in Chrysler, it would represent the first time the U.S. has ever owned an automaker—joining China and several European governments in that club. It is a road less traveled, for good reason, and one America needs to exit.

**Government-Directed Bankruptcy.** The reorganization plan was filed by the government with the Securities and Exchange Commission on Thursday.<sup>1</sup> At the same time, bankruptcy proceedings for the much smaller Chrysler Corporation are being wound up.

Of course, bankruptcy itself is not necessarily bad news; the process is often the only way for troubled firms to reorganize themselves. The process for General Motors, however—as has that of Chrysler—is to be a government-directed and politically dominated affair, funded largely by tax dollars and creating firms controlled by Washington.

The short drive to bankruptcy and nationalization for Detroit began last December, when GM and Chrysler first accepted bailout money from the gov-

ernment. Both firms were required, as a condition of aid, to prepare detailed plans to return to viability. In March, those plans were flatly rejected by the White House, which (correctly) found the changes being proposed far from sufficient to resolve the problems of the firms.

From that moment on, Washington took over the driver's seat for both firms. To emphasize the point, President Obama took the unusual step of effectively, and unceremoniously, firing GM's chief executive officer Rick Wagoner and half the GM board.

**Washington Calling the Shots.** Since that time, the federal government has been calling the shots for both automakers. Tellingly, the reorganization plan Chrysler took into bankruptcy was announced not from the firm's Detroit HQ or a courthouse, but from the White House. And creditors who opposed that deal, pointing out that they would get a mere fraction of what the United Auto-workers Union (UAW) would get for its claims, were personally lambasted by the President for their failure to pursue what White House spokesman Robert Gibbs called the "common good."<sup>2</sup> Thanks to government pressure—and billions in additional taxpayer funds—Chrysler is soon

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(202) 546-4400 • [heritage.org](http://heritage.org)

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expected to emerge from bankruptcy with ownership shared among Italian carmaker Fiat, the UAW, and the federal government.<sup>3</sup>

Now it is GM's turn in court, with a filing expected by June 1. As outlined in the government's SEC filing, current GM bondholders will be offered 10 percent of the firm's stock plus warrants for an additional 15 percent, in return for their \$27 billion in claims. The UAW, by contrast—which is owed some \$10 billion by GM for health coverage claims—will receive 17.5 percent of the stock, plus another 2.5 percent in warrants and \$6.5 billion in preferred shares.

This favoring of the politically influential UAW has led many creditors to oppose the deal. If creditors are not pressured (as were Chrysler creditors) to accept the offer, the issue goes to court, to be decided by a bankruptcy judge.

These relatively small ownership shares, however, will be dwarfed by the 72.5 percent stake to be grabbed by Washington. This stake will come at a cost to the taxpayer: at least \$30 billion in additional loans to be provided to GM, on top of nearly \$20 billion already lent. (Of this, \$8 billion will remain as loans to be repaid.)

This is a staggering amount of money for the bailout of any single firm. More harmful than the direct cost, however, may be the cost of government management of this firm. History provides no reason to think anyone in D.C. knows how to run a car company. A look at the enterprises that Washington already runs—including the Postal Service and Amtrak—does not reassure.

**Dangers of Political Management.** But the danger is not just that politicians do not know how to

run auto companies. It is that they know what they want to use them for. As Robert Reich, President Clinton's labor secretary, said of bailing out banks, "Is our main objective to make sure [banks] become profitable and we get repaid? Or should we push management to take actions that are in the public interest but not necessarily geared toward higher shareholder returns? ... I'd say we should do the latter. Otherwise, why bother bailing out [the companies] to begin with?"<sup>4</sup>

Politicians will use enterprises they control to advance their own agendas—even if those agendas conflict with the goal of making products consumers want to buy. Case in point: EPA Administrator Lisa Jackson has said, "What this country needs is one single national road map that tells automakers... what kind of car it is they need to be designing and building."<sup>5</sup> She was referring to fuel-efficient cars, which the President himself has dubbed the "cars of the future." Consumers, of course, may not agree, perhaps preferring the safety of larger vehicles. But with Washington in charge, it may not matter.

**Exit Strategy Needed.** Ownership, acquired through a government-dominated bankruptcy process, is the wrong approach. GM and Chrysler should be restructured under established bankruptcy rules—without taxpayer money or the federal control that comes with it. But if government ownership does take effect, President Obama and Congress should outline a clear exit strategy for taxpayers, as well as clear guidelines on how the firm is to be run in the interim. Among the necessary steps:

- Establishing a firm, legally binding deadline—perhaps one year—for the sale of the firm back to the private sector.

1. See "Form 8-K for General Motors Corp." at <http://biz.yahoo.com/e/090528/gm8-k.html> (May 29, 2009).
2. 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>.
3. The bankruptcy plan developed by the government employed novel techniques for avoiding claims by upset creditors, by which Chrysler's assets were sold to a newly created entity, leaving a rump, debt-ridden firm. For more detail regarding this approach, see Andrew Grossman, "Bailouts, Abusive Bankruptcies and the Rule of Law," testimony before the Judiciary Committee, U.S. House of Representatives, May 21, 2009, at <http://www.heritage.org/research/economy/tst052209a.cfm> (May 29, 2009).
4. Robert Reich, "We Own the Banks, Now What Do We Do with Them?" *Salon.com*, May 8, 2009, at <http://www.salon.com/opinion/feature/2009/05/08/reich> (May 29, 2009).
5. Lisa Jackson, interview on *All Things Considered*, NPR, April 28, 2009.

- Establishing an expedited schedule for repayment of outstanding federal loans. The repayment should extend no more than 36 months.
- Prohibiting any further taxpayers loans or grants to GM.
- Adopting clear guidance for GM's management and for federal officials overseeing the corporation, making clear that during the period of government ownership, establishing market value and viability, rather than social or political goals, are to be the primary objective.
- Strictly barring GM during the period of government ownership from making any campaign

contributions or engaging in policy advocacy of any kind. Due to its ties to government, GM's role in the political arena while nationalized should be strictly circumscribed.

**Need to U-Turn.** Last month, President Obama declared "I don't want to run auto companies. ... I've got more than enough to do." But like it or not, running auto companies is exactly what the federal government is doing. That is the wrong road for Detroit, for consumers, and for U.S. taxpayers. America needs to take the nearest exit.

—James L. Gattuso is Senior Research Fellow in Regulatory Policy in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.