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"What's Good for GM?"

Featuring Daniel J. Ikenson

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This is the Cato Daily Podcast for Wednesday, November 12, 2008. I'm Caleb Brown. GM's financial problems come at the same time as the meltdown of much of Wall Street. Wall Street got its bailout, now GM is hoping for some of that cash as well. Dan Ikenson, associate director of the Cato Institute's Center for Trade Policy Studies, says the impulse at work is the same. GM and Wall Street both want a payday after years of poor decisions.

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*DI:* When you hear Nancy Pelosi and Harry Reid saying that we need to bailout the industry, what they are saying is that we need to give loans or give cash to three of the many producers: the Big Three. The Big Three account for about 50% of U.S. auto production; they account for about 50% of sales. The other 50% are facing a similar contraction in demand, are facing similar troubles caused by the credit crunch. But they are not marching on Washington for a bailout, and the main reason is that they are doing pretty well despite the current demand situation. The Big Three's problems predate the financial crisis even though their lobbyists and their representatives from the Michigan delegation and the leadership in Congress will tell you it has everything to do with the financial crisis. They have made some very bad decisions which have made them uncompetitive from a cost perspective.

*CB:* How long has this been coming for GM, specifically the serious problems that they are facing right now?

*DI:* Earlier in the decade GM made major capitulations to the unions with respect to work rules, compensation, benefits. Basically UAW workers were given the Cadillac platter of benefits. There were to be paid up to 90% of their salaries when they were laid off.

Basically, GM was disincentivized from laying people off, and as a result when demand contracted earlier in the decade they kept pumping out products. They kept making cars even though there was not much demand for them, and as a result the 0% financing for 5 years, 6 years, 7 years—that concept was born. And on the demand side, Detroit has been making bad decisions with respect to the products they are making. They thought that the period of SUV and big truck consumption would last forever and in fact it has not. If you look at the top 10 selling cars over the past decade, the Big Three produced passenger vehicles have made that list scarcely, maybe coming in at slot 7, 8, 9, or 10. No Big Three passenger vehicle has been a top five seller this decade. So, that begs the question: Why do we want to give them 25 billion dollars to make products that Americans do not want to buy?

*CB:* As the argument goes, this company represents a great deal of workers. There are all sorts of workers who work in related companies that do important things, and at this critical time as we are very clearly entering a recession or have been in a recession for some time period, we should not kick the economy when it is down by allowing this big major American company to fail.

*DI:* You know, I coach my second grader's soccer team in Montgomery County Maryland. In Montgomery County Maryland there are no such things as winners and losers. We don't keep score. Everybody gets trophies. That seems to be what is motivating Nancy Pelosi and Harry Reed. They think that this is a Montgomery County soccer game. In fact, to speak of the Big Two is heresy. But in fact, if we had a Big Two, if one of the Big Three were allowed to go under, workers for the other companies—stakeholders, shareholders in the other companies—would be doing a lot better. There is an argument that it is not just the primary workers at the auto plants themselves but also the parts producers. Well the parts producers are not doing well now because people are not buying many cars. But if one of the Big Three were to liquidate, business for the other two would be doing better and the parts suppliers would have those customers as well. If Americans are going to be forced to subsidize auto producers, why cannot we choose who to subsidize? I would pick maybe Honda, they produce in Marysville, Ohio; or Toyota in Georgetown, Kentucky; or Nissan in Smyrna, Tennessee; Kia in Alabama; BMW in South Carolina. These companies are American companies. They pay U.S. taxes. They employ Americans. They contribute to local charities and support local soft ball teams. They are every bit as much American, and if we are to give 25 billion dollars to the Big Three, we are subsidizing failure. These are the companies that do not deserve those types of contributions.

*CB:* What do these members of Congress expect as a result? Do they think that this money is going to make GM a better company?

*DI:* Right, that is a question that does not seem to be asked much. You are not seeing it much in the mainstream media. All we hear is that the Big Three are bleeding cash. They are facing bankruptcy, imminent demise over a period of three or four months. Why then do we give them 25 billion? What are they going to do with that money? Is it just to slow the process down? To me you are throwing money into the money pit. But Pelosi and Reid and the Michigan delegation walk away with having done something for the Detroit automakers. They have been telling them for eight years that eventually they will bring some goodies home from Washington for you. But the auto industry has been bumping its head up against the wall with the Bush Administration on a variety of issues, and I think the beneficiaries of this bailout are the Pauls.

*CB:* What of the idea that this money might delay the day of reckoning for these pension obligations and health benefits that GM owes to its past and some current workers?

*DI:* I do not think that that is a good explanation or justification for wasting 25 billion dollars, just to buy 6 months of benefits. I think what the auto industry really needs to do

is to follow in the footsteps of the steel industry. The U.S. steel industry at the beginning of this decade faced numerous bankruptcies—red ink all over the place—and after years of going through nominal bankruptcy processes and then being allowed to come back into the world to produce uneconomic output, the steel industry finally realized that they needed to consolidate. In 2001 there were 12 U.S. steel mills accounting for about 75% of hot rolled steel production. In 2007 there are 3 mills accounting for over 80% of production. The steel industry has had its most profitable decade ever this decade, and the reason is that they have consolidated. There is not enough demand for a high fixed cost industry to have so many firms. There needs to be fewer.

*CB:* In a sense bailing out one company is, in terms of both market share and reward for performance, a punishing activity for those other firms in the industry.

*DI:* Absolutely. We need a reckoning in the industry. If I am a shareholder or worker at Ford, I might not say it publicly but “yeah I think I would be doing better if GM were to go out of business. I would have a larger slice of the pie at the moment and Ford would be able to attract some of the best workers from GM and therefore improve its prospects going forward.” The other point worth making here is that the government does not have a very good record of allocating taxpayer dollars wisely. Just a few months ago the auto industry was granted 25 billion dollars in loans to retool. And the reason they were granted that money is because Congress passed this energy bill which required U.S. producers’ fleets to get an average of 35 miles per gallon. Well the Big Three cannot do that yet. So that 25 billion dollar subsidy to retool is basically incentivizing Detroit to make more fuel efficient cars—the kinds of cars Americans traditionally have not wanted to buy and the kinds of cars that Americans are going to be less inclined to buy now that fuel prices are on the decline again. So, we should not have any faith that Nancy Pelosi or Harry Reid has any idea what this subsequent 25 billion dollar bailout is going to do. We have the automakers totally disincentivized right now. They are incentivized to make cars that people are not going to want to consume which has been one of their biggest problems of the past decade. They are incentivized to make these products because their factories are being retooled to make these cars.

*CB:* Dan Ikenson is associate director of the Cato Institute’s Center for Trade Policy Studies. Read more of his work on U.S. manufacturing and trade at [freetrade.org](http://freetrade.org).

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