

Cato Institute Policy Analysis No. -4: A Step Toward Feudalism: The Chrysler Bailout

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Executive Summary

1. Should Chrysler Keep Going?

Since the summer of 1979, Chrysler executives have sought a federal subsidy to save their company from possible bankruptcy, and they appear to be near their goal. (Because the subsidy Congress passed December 21, 1979, will be given only if Chrysler receives private financing and reduces employees' wages, whether the company will get the subsidy is uncertain at this writing.) They have talked throughout their negotiations with the government as if a bankruptcy would necessarily cause them to shut down, but if Chrysler went bankrupt it would agree with its creditors on a future repayment scheme and could survive and even thrive. The company's survival would depend on whether projected revenues exceeded or fell short of projected costs. However, Chrysler executives have talked as if the company would necessarily fail, and therefore I will take them at their word and assume that it will indeed go out of business if the government does not subsidize it.

Should the U.S. government let Chrysler fail? Let's reword the question: Should the government force taxpayers to subsidize a company whose products do not meet the market test? The answer becomes clear: No. Why should taxpayers have to pay to keep a firm in business? As consumers and producers, they have shown that they do not want to keep it going. Consumers are not willing to pay enough for Chrysler's products to cover the company's costs; producers -- including suppliers to Chrysler and Chrysler employees -- are not willing to sell their goods and services at a cost below Chrysler's projected revenues. Consumers and producers have spoken, and that should be the end of it.

Chrysler executives reply that if the company fails their workers will be unemployed and their suppliers will lose business and lay people off. But surely this unemployment of resources cannot last long: if this were a likely prospect, Chrysler would not be in its present bind. Precisely because the resources have higher-valued alternate uses, Chrysler cannot afford to pay them out of projected revenues. Other potential users of the resources are willing to pay more than Chrysler can. The cost of a resource is its value in the highest-valued alternate use, and therefore to say that Chrysler's costs exceed its revenues is to say that Chrysler resources are worth more elsewhere.

In the event the company fails, Chrysler employees and suppliers would be unemployed for sometime -- not, however, because they could not find jobs but because they would want the right job. They would be willing to go without work while searching for the right job because they expect to gain more in income and job satisfaction than they lose in current income.

Evidence supports the contention that unemployment is not permanent when a firm lays off workers. Many firms have failed in the past, and their employees have found other jobs. The example of Boeing is instructive: After Boeing, with about the same number of employees as Chrysler (Boeing had 147,700 workers in 1967; Chrysler had 140,000 workers

in 1979), reduced its labor force by nearly two-thirds between 1967 and 1971, the Seattle-area unemployment rate rose from a low of 3.0 percent in November 1967 to a high of 15.1 percent in June 1971 -- and was back to 8.0 percent by November 1972. One could reasonably expect Chrysler workers' unemployment to be shorter because they are not as specialized as Boeing workers.

II. Too Much Regulation? Then Regulate More

On logical and empirical grounds, Chrysler's argument is defective. But there is an additional argument that the executives have used effectively: Because much of the company's trouble stems from government intervention, the government should compensate it. They point to three interventions in particular. In 1966 Congress passed the National Traffic and Motor Vehicle Safety Act mandating minimum safety standards. In 1970 Congress passed the Clean Air Act Amendments setting maximum standards on emission levels of pollutants and later tightened these standards. In 1975 Congress passed the Energy Policy and Conservation Act mandating minimum average fuel-economy levels for automobiles.

Compliance with these laws requires huge expenditures for research and development. Because these R & D costs are independent of firm size, the regulations act like a lump-sum tax on auto manufacturers. Since Chrysler is smaller than Ford and GM, the tax is a greater percentage of its income. Its existence is threatened more than theirs.

But it is a long way from these facts to the conclusion that Chrysler should be subsidized. First, if this lump-sum tax accounts for Chrysler's position, then American Motors -- a smaller company -- should be in even worse shape than Chrysler, but in fact American Motors is thriving. Second, a lump-sum tax affects only the decision whether to stay in business, not the decision about how much to produce. Precisely because it is lump-sum it does not vary with the amount produced, and marginal production decisions are not affected by it. Chrysler's drop in market share, therefore, cannot be due to a lump-sum tax -- there must be other causes, maybe even mismanagement. Third, if the laws Chrysler points to are at fault, then they should be repealed. (More about this later.) Fourth, although certain government officials, congressmen, lobbyists, and voters have supported the regulations that hurt Chrysler, many of the rest of us did not. We would be taxed to compensate a firm partially destroyed by government, even though we played no part in its destruction. In fact, we are victims of the same laws, laws that force us to pay higher prices for less desirable cars.

III. Political Power: A Step Toward Feudalism

The Wall Street Journal, December 14, 1979, carried a story about Chrysler's chief financial officer, Gerald Greenwald, recently hired away from his position as president of Ford's Venezuelan subsidiary. Mr. Greenwald shuttles to Washington, several times in some weeks, to testify before Congress with Chrysler chairman Lee Iacocca. Frequently, he, rather than Iacocca, replies to congressmen's questions. Some people speculate, says the story, that Mr. Greenwald will become president of Chrysler when the current president retires.

We can be sure that if Mr. Greenwald does become president, his promotion will be due in large part to his ability at lobbying rather than his ability at producing cars.

Not only Chrysler but also most other large firms have a vice-president in Washington full time. The government of a Washington suburb periodically advertises in the Wall Street Journal to entice firms to move their offices to "the greatest concentration of power and influence in the free world." Economist and social philosopher Friedrich Hayek pointed out in *The Road to Serfdom* that when the state takes total control over social and economic life, political power becomes the only power worth having. We are not yet at the stage where government has total control. There are even signs of a reversal of the trend to state control, such as last year's defeat of draft registration. Nevertheless, a Chrysler bailout would be another big step down the road to total government control.

If Chrysler receives the subsidy, its executives will soon learn that the man who pays the piper calls the tune. They will find that some of their business decisions require the approval of a federal official. Then, if they do not object (and how can they?), they will find more decisions subject to government approval. There will even be a push to have the federal government receive shares in Chrysler in return for the subsidy. John Kenneth Galbraith has started this offensive already. He asks in a letter to the Wall Street Journal (August 13, 1979) ". . . if as taxpayers we are to invest

one billion dollars in Chrysler, could we not be accorded an appropriate equity or ownership position? This is thought a reasonable claim by people who are putting up capital."

And that's not all. The executives will find themselves on much weaker ground fighting off increases in government power that hurt them. They cannot use moral arguments (no one would take them seriously) or arguments of any other kind against big government. John Kenneth Galbraith makes this point in the same letter: "Could we not," he says, "ask that all corporations and corporate executives that approve or acquiesce by their silence in this expansive new public activity, refrain most scrupulously from any more of this criticism of big government." If Chrysler receives the subsidy, one more barrier to the growth of government will have crumbled.

Chrysler executives will find themselves powerless to argue, for example, against S. 1608, a Senate bill that would require federal approval for a firm to close one of its plants if the firm has gross annual sales above \$250,000. Under this bill, even if the approval were granted, a firm would have to wait two years before moving, compensate employees for job losses, and compensate local governments for tax losses. Passage of the bill would be a major step toward a return to feudalism. The next logical step would be a law preventing workers from switching jobs and employers from firing employees without government permission. Such a law already exists in the Netherlands and was narrowly defeated in the Senate after being passed by the House towards the end of World War II. S. 1608 is sponsored, ironically enough, by Michigan Senator Donald Riegle, one of the strongest supporters of the Chrysler bailout.

Ironic, but not surprising. S. 1608 is in the same spirit as the Chrysler bailout: It would use the coercive power of government to keep firms and workers in their present location. Only this time the coercion would be directed against firms rather than against taxpayers.

IV. The Way Out

The Chrysler subsidy would violate two political principles that have been highly important in this country: the principle that individuals are responsible for themselves and the principle that the government should treat people equally. It violates individual responsibility by making Chrysler stockholders and employees into wards of the state and taxpayers into servants of the state. It violates equal treatment by bailing out a particular firm. Yet the ends are desirable to many. Who wants to see Chrysler employees suffer, even if only for a short time?

Does the end justify the means? Taken literally, the question must be answered yes. The end justifies the means. What else could? But the end does not justify all means. In particular, the end does not justify a means inconsistent with the end. The end is to help people whose suffering has been partly caused by government. The means suggested is to tax innocent people. This means, by imposing still more government coercion, contradicts the end. There must be a better way out, and there is: Remove, as much as possible, the regulations responsible for the present problem. Four specific steps could be taken.

(1) Repeal the National Traffic and Motor Vehicle Safety Act. This act removes the freedom of motor vehicle manufacturers to produce cars that do not comply with government standards, even if buyers want such cars. Under this act, the National Highway and Traffic Safety Administration (NHTSA) has imposed over forty standards regulating the design and manufacture of passenger cars. The act mandates expensive bumpers, seat belts, starter interlock, head restraints, and other items that add hundreds of dollars to the price of a car. Although it has made automobiles safer, car owners do not value the additional safety at what it costs them; if they did, they would have purchased the safety equipment voluntarily. Ralph Nader argues correctly that without government safety standards, people are not concerned enough about safety because the government abets their accidents with "free" highways and medical care. But the alternative to deciding that government should therefore regulate safety (from which it follows that government should also regulate smoking, drinking, and any other activity that harms our health) is to end the original intervention that caused the problem.

Although the argument against safety regulation does not depend on the actual effects of the regulation, these effects are worth noting. Because safety regulation makes driving safer for occupants, they take more chances and actually increase the hazards to pedestrians. Professor Sam Peltzman of the University of Chicago found the increase in pedestrian deaths due to the NHTSA regulations equal to the decrease in driver deaths.*

(2) Repeal the Energy Policy and Conservation Act. The justification for this act is that it conserves oil by forcing people to drive cars with higher gas mileage. This conservation is at the expense of other scarce resources, however, because cars with higher gas mileage cost more to produce. Car buyers should be able to choose the gas mileage that suits them best. People who want "gas guzzlers" should be able to choose them. After all, they pay for the gas they guzzle.

(3) Repeal price controls on oil and gasoline. One reason car sales have been 90 low lately is that U.S. price controls cause shortages whenever they are set below the market-clearing price. When drivers cannot be assured of gasoline supplies, cars become less valuable. The demand for cars is lower now than it would be if drivers did not believe there was a good chance of future shortages. This uncertainty about the future particularly hurts sales of recreational vehicles, one of Chrysler's few product lines that sold well.

(4) Repeal the laws that force employees to join unions. The earlier statement that Chrysler employees are not willing to sell their services to Chrysler at a cost below projected revenues needs qualifying. Individual employees might be willing to work for less than they are now being paid in order to keep their jobs, but they are not allowed to make that kind of bargain because the United Auto Workers (UAW) union has a monopoly on bargaining for most Chrysler employees. It is illegal for any worker to work for less than the wage the UAW has bargained for. If compulsory unionism were repealed, Chrysler would not be in as serious shape as it is in.

Regulation helped cause Chrysler's problems; more regulation is not the answer. It's time for a new solution. *Sam Peltzman, "The Effects of Automobile Safety Regulation," *Journal of Political Economy* 83, no. 4 (August 1975): 677-725.