



## **Just Say No: Why the Taxpayers Should Not Bailout the Auto Industry**

For the Big Three automakers, years of mismanagement, declining market share, and bankrupting concessions to unions have finally culminated in the current financial crisis facing the U.S. automobile industry. The bridge loans provided to General Motors and Chrysler in late 2008 have hardly been enough for two of the Big Three to survive long-term. With the incoming administration tending to favour a massive bailout for the industry (recall that then Senator Obama encouraged the Congress to provide the auto industry with \$50 billion in October 2008), it seems only a matter of time before the taxpayers are on the hook for yet another multi-billion dollar bailout for companies that are no longer competitive.

The auto industry in America has been dying a slow and painful death over the last few decades as a result of its failure to respond to competition from foreign auto manufacturers who produce quality cars with greater fuel efficiency at lower cost to consumers. In addition, the American automobile industry has been held hostage by greedy, overbearing unions who have forced management via threat of debilitating strikes to make financially irresponsible concessions that have laid the foundation for the current crisis. Management's acquiescence to the demands of the unions have resulted in favourable compensation packages that far exceed those of workers at foreign auto makers, expensive buyouts ranging from \$100,000 to \$150,000+ for workers when factories are closed, jobs banks whereby workers whose positions have been eliminated are paid to show up at the factory each day and practically sit in the commissary, and generous pension and healthcare benefits that increase the cost of each auto by at least \$1,500.

The monies that have thus far been given to GM and Chrysler in the guise of "loans" will likely never be repaid (the automakers have yet to show a feasible way of repaying the loans). These were "gifts" to the companies to prevent them from filing bankruptcy prior to the Christmas holiday, an action that may have resulted in massive layoffs of highly paid union workers. The loans will not be enough to prevent a further weakening of GM and Chrysler and a likely bankruptcy filing by one or both. However, additional bailout funds may very well be provided by the administration of President Obama and the Democrat-controlled Congress. Just as the previous loans were a vast mistake, so too would be providing any additional funding to companies whose business plans are structurally flawed and



unsustainable in the current competitive environment, both short and long-term.

The problems at the Big Three are multi-faceted. First, the unions wield massive bargaining power that they have used to coerce management into making unwise concessions. Historically, management has apparently been afraid to let the unions strike and has consistently chosen to give in to union demands. Stronger management may well have resisted the threat, allowed the unions to strike, and merely waited things out until the unions backed down or the company was forced into bankruptcy (in which case a bankruptcy judge would likely have thrown out the unions' contracts). But management has given in each time, granting more and more pay for union workers. Conceptually, it is difficult to expect a person making minimum wage to buy a car that was made by workers making \$70-\$100 per hour.

Second, the Big Three are competing against lower cost manufacturers from overseas, such as Japan. Nissan, Toyota, and Honda have gradually taken market share from the American auto manufacturers. Consequently, the Big Three have been slow to respond to the production quality and fuel efficiency offered by foreign autos.

Third, the Big Three have not recognized that they are also competing against themselves. GM's Buick competes with its Chevrolet brands and so forth. In an effort to produce every type car that every type person wants, the Big Three have lost sight of Henry Ford's own simple and successful mantra--You can have any colour car as long as it is black. As a result, the dealers are competing against themselves and their parent's own products. The local Buick dealer is competing with the local Chevy dealer, driving profit margins down further and further. Competing against yourself is hardly a wise business strategy.

This may have resulted in some of the Big Three's own misfortune. Local dealers provide warranty work on the manufacturer's cars and then bill the manufacturer for said work. A rigorous audit of this practice by the Big Three would likely reveal that many dealers are submitting invoices for warranty work that was either never performed or that was performed after the warranty had expired and was paid for by the consumer or that was performed unnecessarily. For the Big Three, there is nothing like getting screwed by your own network of dealers. This fraud could account for tens of billions of dollars in losses for the Big Three.

Fourth, the Big Three are still producing cars, even though sales have declined significantly in this economic slump. The American public has neither the appetite nor the money to buy



automobiles right now. Continuing to produce cars on the assembly lines is foolish, particularly if these cars are going to be relegated to holding lots where they will rust away. Any smart business person knows that if your product is not selling, in other words there is not demand for your product, you should pare back production. The carmakers may have figured this out, but wait! The unions probably won't let them shut down production without paying the union workers their full pay and benefits. What a dilemma for the Big Three!

Thinking Outside the Boxe suggests and supports two options for the Big Three. First, the unions have stated with confidence that they believe the industry can restructure and remain financially viable long-term. Whilst we doubt this assertion, we would like to see them put their money where their mouth is and, therefore, suggest that the unions borrow the money to buyout GM, for example. (They could do this with Ford and Chrysler if they so desire.) This would be considered a "UBO" or union buy out as opposed to a traditional "MBO" management buyout. The resulting company would be a quasi-ESOP (employee stock ownership plan). The union leaders could then make all the necessary decisions to make the companies financially healthy, competitive, and viable long-term. This allows the very groups that have driven their employers to near bankruptcy to take all the risk going forward. When they realize that they cannot sustain in the wake of low wage competition from foreign manufacturers, the unions can make the difficult decisions needed to keep their companies alive for the benefit of their workers. If they fail, however, they are out their investments, their retirements, etc. Under no circumstances would any taxpayer money or federal government assistance be permitted to fund the transaction or subsidize the ongoing operations under union leadership.

Alternatively, both GM and Chrysler should file for bankruptcy. Chrysler should be liquidated; it produces nothing that anyone really wants at this point, and its continued existence in the future serves no useful purpose. Under this scenario, GM would sell some of its brands, which still have value, to Ford and would then liquidate the rest of the company. With Ford the only American car manufacturer left alive, it stands to reason that it would emerge a healthier and potentially more competitive company. With less American competition and control of some of GM's valued brand names, it would increase its market share significantly.

In addition, the elimination of GM and Chrysler would give management of Ford significant leverage when it comes to dealing with the unions. With a couple hundred thousand auto workers unemployed



as a result of the death of GM and Chrysler, Ford could go to the unions and demand significant concessions with respect to pay, elimination of jobs banks, pension cuts, health care cuts, etc. The unions, of course, would refuse and threaten to strike at which point Ford management should encourage them to do so in order to bring in non-union workers as scabs. With a couple hundred thousand auto workers unemployed, they would surely put aside their union philosophy and cross the picket line to feed their families. With labour costs reduced to a fraction of the cost of union labour, Ford would then be able to effectively compete against the low labour cost foreign auto manufacturers. The American auto industry, or what is left of it, would be stronger and more secure in its ability to compete with foreign products.

To be sure, there is no easy fix to the crisis facing the Big Three. Saving the auto industry so that it is viable long-term will require painful decisions. But it is not up to the federal government to use taxpayer money to bailout private industry, the leaders of which have made bad decisions and whose business is no longer competitive. Further federally-funded assistance to the auto industry sets a dangerously destabilizing precedent that any industry that needs money to fund ongoing operations can call upon Uncle Sam for help. Weak and uncompetitive businesses fail in a capitalist system. There is no bailout by the federal government to prop up failing businesses in a capitalist system. The doom and gloom projections of the Big Three regarding the number of jobs that will be lost if they fail is merely a scare tactic.

The Big Three and their union antagonists have had their day, and now it is time for them to pay the piper. They have raped the consumer again and again over the years. Now their deeds are coming back to haunt them. Let them fail. The taxpayers' money is better used elsewhere in projects that create jobs or for small businesses to grow or to provide tax relief from an over-taxed American public. Remember what Nancy Reagan advocated (albeit in a different context): Just Say No! It is time for the Congress and the Administration to just say no to any further assistance for the automakers.