

Mom, Apple Pie, and Hyundai?

The auto industry has been a bulwark of the American middle class. If Wall Street warrants a bailout, why not Detroit?

By Pat Choate

IN THOSE HAPPY DAYS of the 1950s, my friends and I anxiously awaited the moment when the local auto dealers began displaying their new car models. My uncle was a Chrysler-Plymouth dealer, and we always began our tours there. Then we would go from one showroom to another, collecting the brochures, sitting behind the wheels of the new Corvettes, Chrysler 300s, Plymouth Sport Furies, and Thunderbirds, opening the hoods and admiring the powerful engines. Rare was the teenager of that era who did not know the specifications of virtually every model produced by General Motors, Ford, and Chrysler.

“Car people” such as Lee Iacocca, then at Ford, were in charge of America’s Big Three automakers. They loved their cars as much as their customers did. The carmakers and their suppliers produced an ever changing set of engines, transmissions, accessories, and gadgets that made buying a car a family treat unlike any other. So many different types of hubcaps were produced that there were hubcap stores in all the major cities. In Texas, stealing them was a state pastime for teenaged boys.

The differentiated line of cars produced by General Motors was also a measure of social and economic status. A Chevrolet was for those starting out. A Cadillac was for those who had arrived. Pontiacs, Oldsmobiles, and Buicks were stop-offs for those on the way up or down. A jump from a Chevrolet to a Buick was an event noticed and com-

mented upon by neighbors as a measure of success—or of someone acting above himself.

In that postwar period, Americans were on the go, and though Charlie Wilson was ridiculed for commenting, “What’s good for General Motors is good for America,” he was right. The Great Depression and World War II were memories, people had well-paying jobs, credit was easy, and a new car could be bought with a small downpayment. GM and the auto industry were a major part of the economy and an important contributor to that prosperity.

The Big Three autos, coupled with the construction of the 42,500 mile Interstate Highway System and the establishment of a vast network of safe and inexpensive motels such as Holiday Inns, opened the continent for inexpensive family vacations. Dinah Shore’s perky signature song captures the essence of America’s love affair with its cars: “See the USA in your Chevrolet. America is asking you to call. America is the greatest land of all.”

But success bred complacency and hubris in the industry. By the mid-1960s and early 1970s, management of the Big Three had shifted from the car people to “numbers guys,” who were more interested in squeezing every possible penny of profit from the vehicles. To avoid costly worker strikes, Big Three management made major concessions to labor on pensions, healthcare, and vacations, costs it then passed on to consumers. Meanwhile, quality slipped. Designs were unimaginative. Buyers

would ask whether a car was produced on a Monday or Friday, fearing that either the workers were too exhausted and hungover after the weekends to do a good job or too anxious to leave on Friday to care.

By the late 1960s, the Big Three had become an easy target for Japanese and European competitors. In 1980, Chrysler faced bankruptcy, and General Motors’ management seriously considered exiting the auto business altogether. As part of that strategy, GM bought Hughes Electronics and Ross Perot’s EDS.

Perot and the GM management quickly soured on each other. He wanted to manufacture the best cars in the world, and they wanted to enter into businesses in which they were inexperienced. One of the more interesting business lectures captured by the Harvard Business School in its case studies is Perot’s speech to the GM board on the day he concluded his sale of stock back to the company. He ticked off what he thought was wrong with GM and what it needed to do assure its prosperity in the auto industry. The essence of his message was to treat workers well, be innovative, settle for nothing less than making the best cars in the world, and sell them at the lowest possible price. His advice was ignored, of course, and GM continued to lose position in its domestic market.

Eventually, GM, Ford, and Chrysler’s plodding efforts to build better vehicles began to pay off in the early and mid-1990s. Quality improved, styling began to

matter once again, and the Big Three produced the kinds of vehicles Americans wanted—big, comfortable, powerful, and safe. Easy credit and cheap gas made owning the behemoths inexpensive, and Detroit seized control of the market for full-size pickups, vans, and SUVs.

A key moment for the Big Three and UAW came after their signing of the 1996 labor contract. GM thought it had bought three years of labor peace. But the union unexpectedly staged a series of local strikes in facilities that produced strategic parts, the shortage of which could stop all GM production. These snap strikes closed GM for part of 1997 and cost the company billions of dollars. For whatever advantage the union may have gotten, its actions enraged GM management, which accelerated its investment in duplicative plants in other parts of the world, staffed with nonunion workers.

In 1999, GM spun Delphi, its parts division, into a new corporation that entered Chapter 11 reorganization in 2005. The UAW contract was broken, and the workers were left with \$14 per

its interest to Cerberus, a private investment fund.

It is difficult to teach an elephant to waltz, but it can be done. While the Big Three have been slow to change, they have adapted well enough that they still hold half the U.S. market share. It is an amazing turnaround.

Consider quality. In 2007, Ford won 102 quality awards, including AutoPacific's Best in Class for three models and Germany's largest auto magazine's Auto 1 of Europe Award for its S-MAX. *Forbes* awarded the 2008 Chrysler 300 "the highest-quality car in the near-luxury category" over the Audi A4, BMW 3 Series, Lexus IS, and Mercedes-Benz C Class. Of the 15 global finalists for the 2008 Motor Trend Car of the Year Award, the Big Three manufactured nine, the Japanese four, and the Europeans two. The 2008 winner was GM's Cadillac CTS, which *Motor Trend* described as "proof that Detroit can still build a world-class sedan."

As for innovation, General Motors, Ford, and Chrysler invest almost \$12 billion annually on R&D, making them a

vehicles, mostly motor and battery innovation; and emerging related technologies, including solar, wind, and other green inventions.

GM has higher average quality and newer green technology and patents than the other 14 auto manufacturers combined. Together with Ford it holds approximately one-third of all green-technology patents and the related value. Moreover, GM has 70 percent of the patents in the emerging-technology category. This domestic share increases to 85 percent if Ford is added. Finally, Ford owns 30 percent of all patents with a similar related-value measure in emission-control innovation. These Big Three technologies have great potential for stimulating overall U.S. economic and job growth and creating a greener and more fuel-efficient world.

There is much of value to be saved in this vital industry, but relief has been slow in coming. When Wall Street recklessly gambled with borrowed monies and lost, federal aid was characterized as a "bailout." The present auto crisis was created by powerful economic forces, many beyond Detroit's control. Federal efforts to save the U.S. auto industry would constitute a "rescue."

The primary causes of the current U.S. auto-industry crisis are threefold: a financial freeze in which even well-qualified borrowers are denied credit to buy vehicles; fluctuating oil prices that have driven the price of gasoline from less than \$2 per gallon to more than \$4 and then back to \$2, all in less than 10 months; and a consumer panic that has cut retail sales to 15-year lows.

The failure of the U.S. Treasury Department and Securities and Exchange Commission to monitor, let alone regulate, Wall Street has created today's financial wreckage and the resulting consumer panic. And despite the obvious need for a far-sighted energy policy, the last four presidents and Congress

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hour jobs, no healthcare, and no defined-benefit pensions. President Lyndon Johnson was once asked if half a loaf of bread was better than none. He replied, "A slice is better than none." The Delphi workers got a slice.

Over the past two decades, each of the Big Three has been through extensive management changes, downsizing, and layoffs. Chrysler even became part of the German company Daimler, which could not make the acquisition profitable and eventually sold 80 percent of

major source of technology development. In 2007, the U.S. Patent and Trademark Office granted these three corporations 1,030 patents.

James E. Malackowski, CEO of Ocean Tomo LLC, a merchant bank that specializes in intellectual property products and services, recently compared four of the green, clean, and energy efficient patent portfolios held by the Top 15 global automakers—emission control, catalytic converters, and related chemistry; fuel cells; hybrid/electric

have done little but encourage more drilling.

The longer-term inability of America's auto industry to export competitive products has its origins in U.S. trade policies that accept closed foreign auto markets and the payments of massive export rebates by other governments to their automakers. How can U.S. automakers be expected to compete in a world where German producers get a 19 percent export subsidy on every vehicle sold in the United States, China undervalues its currency by up to 50 percent, Japan keeps its auto market tightly closed, and the U.S. government allows South Korean automakers to sell more than 700,000 subsidized vehicles in this market annually, but tolerates Korea's restriction of U.S. imports so tightly that fewer than 7,000 American-made vehicles are sold there each year? The Big Three and the UAW are not at fault for these distortions of competition.

The three overarching questions that President-elect Obama and the 111th Congress face are: what will happen if the Big Three are not saved, how much will it cost, and what is the best way to execute the rescue?

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As to the first question, federal inaction would be costly and destructive in ways America has not experienced since the Great Depression. The Center for Automotive Research—appropriately, CAR—projects that a 100 percent closedown of the Big Three auto producers would result in the loss of almost 3 million U.S. jobs in the first year. The majority of those losses would be Main Street jobs distributed across the country that depend on spending by the Big Three—steel, glass, and rubber produc-

Employment Impact of a 100 Percent Close of Big Three			
(Rounded to nearest thousand)			
	2009	2010	2011
Direct Employment (Big Three)	-239,000	-239,000	-206,000
Indirect Employment (Suppliers)	-974,000	-795,000	-545,000
Spinoff Employment (General Economy)	-1,738,000	-1,427,000	-1,021,000
Total Employment	-2,951,000	-2,462,000	-1,772,000

Source: "Car Research Memorandum: The Impact on the U.S. Economy of a Major Contraction of the Detroit Three Automakers," Center for Automotive Research, Ann Arbor, Michigan, Nov. 4, 2008.

ers and the 20,000 dealers, who are major purchasers of advertising in local newspapers, radio, television, and other small business services provided by lawyers, accountants, real estate contractors, and landscapers.

A 50 percent reduction in the Big Three's operations would be almost as costly. CAR estimates that 2.47 million jobs would be lost in the first year, 1.5 would still be unfilled in year two, and slightly more than 1 million in year three. The lost revenues from either scenario would devastate federal, state, and local budgets, creating further economic

upheavals. CAR estimates that a 100 percent shutdown would cost \$156 billion in lost tax receipts and increased transfer payments. A 50 percent shutdown would cost \$108 billion.

Job loss is only part of the risk. The U.S. defense industrial base would be greatly weakened if the Big Three failed. The collection of machine tools, robots, production lines, and skilled workers of the auto industry gives the United States the capacity to shift quickly from domestic production to the manufacture of

tanks, airplanes, and other war materiel as happened in World Wars I and II. The foreign auto transplants are not a substitute, for they are mostly facilities for putting together kits manufactured abroad.

As for the cost of the auto rescue, it is impossible to estimate the final number. Certainly, \$38 billion for an operational bridge loan is too little and will require supplements. GM alone has a cash-burn rate of \$2 billion per month, and will use its portion of the first loans within months. Yet the earliest that GM says that it can produce its new line of vehicles is 2010. Inevitably, the automakers will be back for more, much like the banks and insurance companies.

As CAR has documented, however, the costs of inaction will also be great. Its estimates of a collapse, moreover, do not include the costs of shifting more than \$100 billion of Big Three pension liabilities to the Pension Benefit Guaranty Corporation, which is currently operating with a \$10 billion deficit. Only about a quarter to a third of the Obama administration's proposed stimulus of massive investment infrastructure expenditures will be felt in 2009, half in 2010, and the remainder thereafter. As presently defined, it will have little effect on the Big Three.

They need more sales now. The fastest and surest way to stimulate such activity is for the federal government to give a massive one-to-three-year tax deduction for sales of U.S. vehicles with a high U.S. or North American content, such as 70 percent. This would help clear the dealer backlog and immediately put people to work. It also would allow taxpayers to get great bargains on new vehicles.

Some have suggested that Chapter 11 is the only viable option for the Big Three. But it would create an economic avalanche in which dozens, if not hundreds, of suppliers and dealers would be forced into bankruptcy. No institution other than the federal government is now able to provide the billions of dollars necessary for the industry to operate during reorganization. And at the very moment that these auto giants need to act quickly and be flexible, they would be constrained by a federal judge and trustees to get approval for even the most basic decisions. Those who advocate bankruptcy need only look at the cumbersome and costly Delphi experience, which is now in its fourth year.

But rescuing the American auto industry will require more than vast sums of public monies. Basic policy changes in trade and tax laws are essential. One of the most difficult, but unavoidable, challenges will be to end the Value Added Tax discrimination faced by the Big Three in both their domestic and foreign markets. Soon after World War II ended, U.S. trade negotiators agreed to allow the rebate of Value Added Taxes on their exports and the imposition of VAT equivalents on their imports of U.S. goods and services. Europe was rebuilt decades ago, but 153 nations now have a VAT, and its average rate is 15.5 percent. Japan has a 5 percent VAT, China's is 17 percent, Germany's is 19 percent, and France imposes 19.6 percent. The economic

consequences to the Big Three and other U.S.-based manufacturers have been devastating.

When a German automaker exports a vehicle into the U.S. that costs \$50,000, for instance, it receives from the German government a 19 percent VAT export rebate, worth about \$9,500. But when one of the Big Three exports a \$50,000 vehicle to Germany, it must pay the German government a 19 percent, \$9,500 VAT-equivalent tax at the dock. Thus the Big Three products are price disadvantaged in both markets. Moreover, these discriminatory VAT rules provide a powerful incentive to outsource production from the United States. In the Tokyo, Uruguay, and Doha trade negotiations, the U.S. Congress

tures, plus long-term warrants, whose purchase price is set at today's stock values. After all, we are taking the risk. When any public loans are repaid, the terms and conditions should require a sale of those stocks, hopefully at a substantial public profit. Taxpayers made almost a 30 percent profit on the Chrysler loans three decades ago.

Second, demands for a reduction in worker pay should be eschewed. The UAW and its members have already made massive wage and benefit concessions in recent negotiations. Delphi is only one example. Almost a century ago, Henry Ford paid his workers a then unheard of \$5 per day so they could buy the products they were making, and the

INDIA IMPOSES A 100 PERCENT TARIFF ON IMPORTED U.S. VEHICLES. CHINA'S TARIFF RATE IS 25 PERCENT. KOREA HAS LONG-RUN NATIONAL ANTI-IMPORT CAMPAIGNS THAT INCLUDE TARGETING FOR TAX AUDITS ANYONE WHO BUYS A FOREIGN CAR.

instructed American trade negotiators to eliminate this tax disadvantage, but other governments refused to discuss the issue.

In addition to pressing for the adoption of new global trade rules to end VAT discrimination against U.S. manufacturers, the incoming administration should focus on eliminating the many protectionist national tariff and non-tariff trade barriers crippling the Big Three. India, for example, imposes a 100 percent tariff on imported U.S. vehicles. China's tariff rate is 25 percent. Korea has long-run national anti-import campaigns that include targeting for tax audits anyone who buys a foreign car. Unless foreign economic protectionism is confronted immediately and at the highest levels of the U.S. government, the American auto industry cannot survive.

Three other principles are essential to the rescue. First, taxpayers should receive substantial equity in these ven-

auto industry led the way in creating an American middle class. This rescue should not undermine broader efforts to provide secure jobs and benefits, nor should it allow the pitting of well-paid American workers against the penny-wage labor of other countries.

Without question, the UAW has often been smug, arrogant, and inflexible. But rather than punishing it by requiring reduction in its members' pay, we should expect the union to contribute to the rescue. It should enter into a no-strike agreement until the federal loans are paid and invest its \$1 billion "rainy day" reserve, commonly called its "strike fund," in the preferred stock of the Big Three until the loans are satisfied. The rainy day has come, and if taxpayers are putting up money to save UAW jobs, so should the union.

While U.S. antitrust laws allowed the UAW to target one company at a time,

those same laws prevented the Big Three from negotiating together on an industry-wide contract. Any rescue should permit the Big Three and UAW to negotiate an industry wage and benefit package.

Third, executive pay at the Big Three should be capped at some simple multiple of the average annual pay of Big Three workers, such as 10 or 15 to 1, with any bonuses being provided in corporate stock, at least until any federal loans are paid off. Also, the Big Three executive pension funds should be required to have at least a majority of its capital invested in Big Three stock. The goal, of course, is to create a common incentive for labor and management to work together.

As of mid-November 2008, the U.S. Treasury and the Federal Reserve had advanced \$2 trillion to salvage the financial wreck created by Wall Street. In late November, the FDIC announced that it was ready to loan another \$1.4 trillion to stabilize the banks. The Bush administration and Congress seem to have no limits to their concern about Wall Street.

The Big Three automakers, their suppliers, and dealers are on Main Street. They employ millions of workers and provide essential goods for American consumers. If the Big Three fail, an economic tsunami will quickly roll across the United States, destroying jobs, incomes, and national confidence at historic levels. The challenges faced by the new administration at that point would be similar not to those faced by Franklin Roosevelt, but to those that confronted Herbert Hoover in the first years of the Great Depression.

In this instance, what is good for General Motors is good for America. ■

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A Surge of Skepticism

What failed in Iraq won't prevail in Afghanistan.

By William S. Lind

WAR IS THE MOST COMPLEX of all man's activities, calling forth his full physical, mental, and moral powers. This renders determining cause and effect challenging. Did the North win the Civil War because of better generalship? J.F.C. Fuller argues that it did: Lincoln found two good generals, Grant and Sherman, while the South had only one, Lee. Or was it the "Anaconda strategy," including the Union's blockade of the Confederacy, that doomed a largely agrarian power? Or was it the North's moral appeal to abolitionists in Britain and France, which prevented those countries from intervening on behalf of the South? The debates will go on forever, or at least until the Confederacy finally wins.

The challenge is compounded when an interest—an ideology or political party or military bureaucracy or defense industry, to name the most common—deliberately distorts history to "prove" a cause-and-effect relationship from which it benefits. Exhibit A is "winning through air power," also known as strategic bombing, the founding myth of the U.S. Air Force. Despite the conclusion of the Strategic Bombing Survey immediately after World War II that the bombing of Germany was largely a failure, the Air Force has continued to argue that air power used simply for bombardment can win wars. (When aviation has been integrated with the

maneuvering of ground forces, it has sometimes proved decisive.) The result has been another failure of strategic bombing in Korea, failure yet again in Vietnam, a recent failure in Kosovo, and an ongoing failure in Afghanistan. For the Afghans, the latest version of Russian roulette is celebrating a wedding.

The most portentous case of misunderstanding military cause and effect in America's current wars revolves around the "surge." As so often, the misunderstanding is promoted and extended by interests with axes to grind, in this case the Bush administration and the neocons. Their propaganda has been sufficiently extensive that most Americans now believe the relative quiet in Iraq is a result of our surging thousands more American troops into that unhappy country.

Worse, among those falling for this *post hoc ergo propter hoc* fallacy we must apparently include the arriving Obama administration. During the campaign, Barack Obama repeatedly called for shifting American troops from Iraq to Afghanistan to create a new surge in another failing war. Any hopes that this was merely campaign rhetoric, designed to quell charges that Obama was "weak on defense" compared to McCain, seem unfounded. The Nov. 11 *Washington Post* reported on its front page, "Obama also intends to move ahead with a planned deployment of thousands of