

## **U.S. “Industrial Policy”: The Bail-out of GM and Chrysler**

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The last two years have not been kind to the world's motor vehicle companies. Even such well-managed companies as Toyota and BMW have posted losses and watched their stock-market values decline by 40 percent. The U.S. producers have suffered even more because a large share of their domestic operations was not competitive even before the 2007-09 recession. When two of the U.S. companies, Chrysler and General Motors, faced the prospect of bankruptcy in 2008, the U.S. government moved quickly to supply them with the financial resources to maintain operations. This intervention did not “save” either company; each descended into bankruptcy anyway. The third U.S. producer, Ford, has avoided bankruptcy, but it is also suffering substantial losses.

The government's injection of billions of dollars of liquidity into Chrysler and General Motors has not affected the long-run survivability of either company or its assets. All three Detroit producers face the same problems: difficult labor relations, relatively inefficient production facilities, and the inability to produce vehicles that American consumers want. None of these problems can be solved simply by injecting capital into and subsequently orchestrating the reorganization of two of these companies.

Let me to begin with the loss of market share. In 1988, the Detroit Three producers accounted for 74 percent of light-duty truck and passenger car sales in the United States. Last year, they accounted for just 48 percent. Their loss of market share was even more pronounced in the passenger-car segment, where they declined from 71 percent to 36 percent. Because the U.S. has a 25 percent tariff on imported trucks, the Detroit Three were able to retain a much larger share of the light-truck market – 62 percent in 2008. However, the foreign “transplant” operations – production lines located in the United States but owned by foreign producers – have begun to devour market share in this light-truck segment in recent years, placing the Detroit Three at risk in even their traditionally more profitable operations.

The government's bail-out and reorganization of General Motors has done nothing to stem GM's loss of domestic market share. The same management remains in place, and the company's ability to develop new, appealing models has not been affected by the bankruptcy reorganization. The government retains a majority interest in the company and has indicated that it will press GM to

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produce energy-efficient cars, precisely the type of vehicles that GM has been unable to develop for decades. The expropriation of the bondholders in the final bankruptcy settlement, facilitated by the fact that many of them were large banks who were themselves beholden to government bail-outs, will make it more difficult for GM to raise debt capital to fund new vehicle platforms.

The Chrysler bail-out ended somewhat differently. Chrysler emerged from the government-funded transition with a majority of its shares owned by its union, not the government. Equally important, Fiat was awarded a 20 percent ownership share in return for assuming the leadership of the company and transferring its small-car technology to Chrysler's North American operations. Chrysler's passenger car sales have almost disappeared, and it apparently has little in its product-development pipeline. Fiat has managed to revive its European operations rather spectacularly, but it has not attempted to sell its mix of small passenger cars in the United States. There is no reason to believe that U.S. consumers will view Chrysler-produced Fiats as worthy alternatives to U.S.-produced Hondas, Nissans, or Toyotas. Nor is there reason to believe that these cars can be produced economically at Chrysler's plants which are located primarily in the heavily-unionized Great Lakes states. For this reason, Chrysler-Fiat has hinted that it may begin producing some cars in Mexico.

This brings me to the other major problem that the government bail-out has not corrected. The Detroit Three have traditionally paid higher employee compensation and obtained lower productivity from their unionized workforce. The transplants – Japanese, Korean, and German-owned operations – have located virtually all of their plants in areas that are far from the union strongholds, in states such as Tennessee, Kentucky, and Alabama. As a result, they have lower production costs than their Detroit rivals. Nothing in the bail-out changes this dynamic. Indeed, both bankruptcy decisions give the United Autoworkers (UAW) an important equity stake in the reorganized companies. It is possible that transferring the UAW's interest from a fixed claim on the companies' assets to a variable, equity-based claim may more appropriately align the incentives of the union and the company, but even this is not clear. The current workers may be loathe to sacrifice for the good of the company if most of the benefits go to the much larger number of retirees that are to be supported from the UAW's ownership interests in the companies.

In short, the government's bail-out of Detroit automobile producers is not likely to save these companies from continued decline. Even if their workers accept declines in compensation and agree to measures to raise their productivity somewhat, the Detroit producers will continue to lose market share. Indeed, in the current recession, their loss of share continues and has even accelerated.

The reason for supporting these companies through carefully-orchestrated bankruptcy reorganizations was more related to short-term concerns about macroeconomic stability in 2008 and the fear that the old industrial areas in Michigan, Illinois, and Ohio would decline even faster than they have, not to any belief that the Detroit companies can recapture their former glory. The unemployment rate in Detroit is now 25 percent despite the bail-out. The U.S. government would be wise to turn its attention to the problems of Detroit and other large Great Lakes cities rather than trying futilely to preserve dying Detroit-based auto companies.

