



Editorial: The Mother of All Moral Hazards

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December 16, 2008

The auto industry rescue package that was rejected by the Senate need not be the last option for federal intervention. Instead, President Bush should immediately announce that the government will ensure funding for a debtor in possession (DIP) loan for GM and Chrysler that will allow the companies to file for bankruptcy in an orderly manner.

Funding for this loan should come from the financial institutions that have received Troubled Asset Relief Program (TARP) funds. In the same way that the heads of the major commercial and investment banks were ordered to accept TARP funds, these institutions must accept a mandate to provide debtor in possession funding. If they cannot come up with enough money, the government should provide the balance. To encourage participation, President-elect Obama should voice his support for this plan and his commitment to ensuring the long-term viability of the US auto industry.

If GM and Chrysler are forced to file for bankruptcy without support from the government, and the market does not provide DIP financing, it would cause what UAW President Ron Gettelfinger has termed a "run on the bank" where suppliers would refuse to provide credit to auto companies resulting in a complete shutdown of the industry.

On the other hand, if the loans rejected by Congress were to be reconsidered and approved, they would merely forestall an inevitable bankruptcy and provide little incentive for the auto companies to enact the major restructuring that can make it profitable in the current, low-demand environment. GM is saddled with over \$60 billion in debt, which it cannot service, and its current labor contract with the UAW puts it at an unworkable competitive disadvantage to its non-US rivals. These burdens cannot be lifted without going through bankruptcy. NYU law professor and former airline executive Michael E. Levine said the failed \$14 billion rescue package would have created the Mother of all Moral Hazards. The UAW and the industry's creditors will hold out for "full pay to the last day" (in the words of Eastern's and TWA's unions at the time of their bankruptcy). No Car Czar will be powerful enough to achieve the reform the industry needs.

The automakers must go through bankruptcy. The assertion that bankruptcy would "cause the loss of hundreds of thousands of jobs and even greater havoc," as the *New York Times* stated in its December 12 editorial, is fear-mongering. A well-funded bankruptcy, with the support of the incoming Obama administration,



would facilitate an orderly – but not necessarily fast – return to profitability. Jobs will be lost, but only as necessary to achieve profitability.

Arguments that consumers will not buy cars from bankrupt automakers are overblown. Consumers already realize that bankruptcy is a real threat, and an actual bankruptcy would be no worse than the current environment. By contrast, the \$14 billion rescue package would create enormous ill will among consumers, resentful over taxpayer funded government bailout measures.

Some claim the \$70/hour wage paid to UAW workers is a myth. The reality is that the automakers pay \$70/hour, but only \$55/hour goes to the workers (while workers at non-US manufacturers are paid \$45/hour). The other \$15/hour goes toward health benefits for retired workers, who would otherwise be covered by Medicare. This is an example of a major structural imbalance in the automaker's business model which can be rapidly corrected through an organized bankruptcy.

Political contributors and lobbyists have a major stake in this debate, and are actively fighting bankruptcy. The Democratic Party has received enormous financial support from the UAW, as well as "on the ground" support from UAW volunteers. Chrysler is supported by extensive lobbying efforts on the part of Cerberus, Chrysler's private equity owner, whose chairman, John Snow, is a former Bush cabinet member. For the Obama administration to take a stand against these special interest groups would show that "change you can believe in" is more than just campaign rhetoric.

The *New York Times* says there cannot be a long-term solution to the auto industry without the \$14 billion rescue package. But this package is nothing more than another Band-Aid bailout. Our political leaders must seize the opportunity and take the first step to put the automakers on a solid long-term foundation.

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