

# SETTING THE RECORD STRAIGHT ON GM

BY ROSS EISENBREY

The Obama administration's intervention to save 1.5 million jobs and many small businesses by preventing the liquidation of General Motors and Chrysler is both momentous and controversial. Legitimate questions have been raised about the wisdom, fairness, and likelihood of success of these interventions. But some of the most widespread assertions are untrue or misleading. In the interest of setting the record straight, EPI Vice President Ross Eisenbrey addresses some common questions that deal with important aspects of the GM bankruptcy.

## ***Q. Who will own the new GM that emerges from bankruptcy?***

- A. The owners will be:
1. The federal government: **60%**.
  2. The Canadian government and the Ontario provincial government: **12.5%**
  3. An independent health care trust (VEBA) for GM retirees: **17.5%**
  4. Unsecured bondholders: **10%**

## ***Q. Isn't this an unprecedented intervention by government in the private economy?***

- A. **No**, it's neither the first time a company has actually been owned by the government nor the biggest intervention in dollar terms. In 1974, the government took over six bankrupt railroad companies and created a new government corporation, Conrail, which it operated for 12 years until it was profitable, and then sold it to private investors. The government's investment in AIG is three times larger than its \$50 billion investment in GM.

## ***Q. Fifty billion dollars is a lot of money for taxpayers. How can this be justified?***

- A. The alternatives were much worse. If GM went out of business or broke apart and sold its assets separately, nearly 1 million workers at GM, its suppliers, and other dependent businesses like restaurants and gas stations in towns where factories are located, would be unemployed. Instead of earning a living and paying taxes, they would become

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dependent on unemployment compensation, food stamps, Medicaid, re-employment services, and other federal and state safety net supports. The financial analysis firm IHS Global Insight, Inc. estimated the cost of a GM liquidation to be between \$100 billion and \$200 billion. The Center for Automotive Research predicted a \$108 billion loss of federal, state, and local taxes over three years if GM were to go out of business. In addition, countless businesses around the country are impacted by the health of GM. *The Wall Street Journal* accurately described “an ecosystem” of companies, from advertising firms in New York to technology makers in Silicon Valley, that derive substantial business from the auto industry. It is clear that the net cost to taxpayers of GM liquidation would far exceed the cost of the restructuring.

Moreover, there is a significant upside potential for the taxpayers, who are not simply giving GM money but buying equity in the company. If the reorganized GM succeeds, taxpayers, through the government, will be able to sell their stock and recoup the investment.

**Q. *How will the new GM be managed? Will the government and the United Auto Workers (UAW) make all the decisions?***

- A. No.** GM’s management will decide what products to manufacture, where to make them, and how to price them. It’s true that many things have already been decided as part of the government intervention, including the terms of GM’s collective bargaining agreement with the UAW, which GM brands will be discontinued, and which plants and dealerships will be closed in the coming months. And most trustees of GM’s new board of directors will be government-appointed. But President Obama plans to leave management to the board and keep the government out of the company’s day-to-day operating decisions in the months and years ahead.

The Voluntary Employee Beneficiary Association (VEBA), a trust fund created to reduce GM’s liability for retiree health care costs, will own 17.5% of GM’s stock. The UAW will own no stock and will have no control over who manages GM. Though some of the VEBA’s trustees are chosen by the union, a majority are independent. And the VEBA, like the Canadian government, will appoint only one of GM’s new board trustees.

**Q. *Doesn’t this agreement reverse many of the normal rules of bankruptcy and capitalism? Isn’t the government favoring UAW members over bondholders, who lent money to GM?***

- A. Yes and no.** This is a better deal than workers often get in bankruptcy, where it is common to see their collective bargaining agreements abrogated, their claims to retiree health benefits wiped out, and their pensions frozen or reduced. But the UAW and its retirees have already given up tens of billions of dollars in wage and health care concessions over the last four years and in this bankruptcy deal to help GM survive. And although GM will still be obligated to fund 75% of the health insurance coverage it promised them, the retirees are not guaranteed lifetime coverage. GM will first have to regain profitability, since half of its future payments to the VEBA will be in the form of company stock.

GM’s current shareholders will see the stock they bought or inherited lose its entire value, and unsecured bondholders will have to accept 10% of the equity in the new GM rather than cash in payment on their bonds. Considering that they probably would not have received anything were it not for the government intervention, this outcome, while unfortunate, is fair. Secured bondholders, on the other hand, will have their bonds repaid in full. Bankruptcy law typically gives high priority to the claims of secured bondholders and that practice is being upheld in this case.

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***Q. Isn't GM's union, the UAW, responsible for GM's problems? Aren't the Japanese companies like Toyota doing better because they don't have to deal with union work rules and uncompetitive wages?***

- A. GM's problems stem from many sources, including bad U.S. trade policies, our failure in the United States to provide health insurance for all or to require all employers to pay their fair share, bad management and product decisions, volatile gasoline prices, and the recession. None of these factors were in the union's control. Union work rules haven't made GM less productive. The fact is that the UAW plants are more productive than the foreign-owned plants, including Toyota's. According to the independent Harbour Report, the 10 most productive assembly plants in the United States are all union facilities.

Auto workers around the developed world are generally unionized and paid wages as high, or higher, than UAW wages, yet French, German, and Italian automakers are in much better financial shape than GM. Toyota and many other foreign companies operating in the United States have set their U.S. wages close to UAW-negotiated levels as a way to attract good workers and deter unionization. It is true, however, that UAW-negotiated retiree health benefits have burdened GM with huge liabilities, made its cars more expensive, and hurt the company's bottom line. GM, which has been in business in the United States for 100 years, has more than half a million union retirees and dependents drawing health care benefits, but only about 60,000 active workers. The foreign companies operating in the United States, on the other hand, have virtually no retirees and have taken no responsibility for their health insurance. In Japan, by contrast, Toyota, Nissan, and Honda's retirees all have health insurance coverage paid for two years by the companies and then by national health insurance. The cost is so low that it reportedly does not appear on Toyota's books.

Over several decades, GM avoided its responsibility to set aside funds to pay the retiree health benefits it promised and did not support national health reform that could have relieved some of its burden. Together, these mistakes doomed the company to eventual bankruptcy.

Wages and benefits at the new GM will be greatly reduced: most new employees will be paid only \$14-15 an hour, and they will not qualify for a company pension. All employees will pay more for their health insurance and will not be guaranteed overtime pay for working more than eight hours a day.