"Government Motors," Hillsdale

By Paul Ingrassia

Call it a summer blockbuster. The new General Motors Company, as distinct from the old General Motors Corporation, recently filed regulatory notice for an initial public offering of its stock. Chrysler will follow, probably in the first half of next year.

There's a certain ironic symmetry to these developments. Two years after the bailouts of Wall Street and Detroit, the banks that went broke are taking public the car companies that went broke. Is this a great country, or what?

The announcement of GM's IPO, one of the largest ever, has notable political elections in this mid-term election year. The Obama administration, aka GM's principal owner, fears significant setbacks in this November's mid-term elections, perhaps losing one or possibly even both houses of Congress. With unemployment remaining stubbornly high the administration is eager to show pre-election evidence that at least one plank of its economic program is working.

Given that the other planks include new health-care and financial-regulation laws that are longer and less comprehensible than books on quantum physics, the competition isn't tough. Having General Motors return to private ownership, and shed the sobriquet of "Government Motors," would provide a big win for the administration.

Whatever the motives, though, the IPO's timing means that we taxpayers will get repaid, at least in part, earlier than expected for the $50 billion or so spent to save GM. Getting full repayment would require GM's IPO shares to fetch $70 billion (there are other owners besides the U.S. government), which is about as likely tail fins reappearing on American roads.

But early partial repayment would be a good start, and if it means putting up with political motives, this taxpayer will be grateful anyway. Just show me the money.

In this case, what's good for General Motors really would good for America, as "Engine Charlie" Wilson said (more or less) some 60 years ago. If the auto bailout is working, as the recent financial results from GM and Chrysler indicate, it's because the Obama administration (for once) didn't succumb to gross ideological overreach in trying to revive Detroit.

This doesn't mean that the bailout was popular. In fact, it seemed more controversial than even the bailout of Wall Street and the banks, even though that rescue cost taxpayers seven times more than saving Detroit.

But it's cars, not banks, that are celebrated in music, film and the American psyche. The Beach Boys' 1963 hit "Shut Down" was about a drag race, not a bank closing. Wilson Pickett's hit three years later was "Mustang Sally," not "Mustang Sallie Mae."

Nor was the Detroit bailout was executed perfectly. In fact it included some inherent unfairness, not least of all to Ford Motor. It's the one Detroit car company that decided to forgo bankruptcy and government aid, and thus remains saddled with three times the debt that GM is carrying.

But unlike health-insurance "reform," the automotive bailout was not a permanent takeover of a large swathe of the U.S. economy. And unlike the new financial-regulation overhaul, the bailout didn't permanently expand the federal bureaucracy. (Worse still, the new financial regulations don't even touch the two profligate financial agencies -- Fannie Mae and Freddie Mac -- that helped cause the crisis.)

Instead, the auto bailout was conceived from the start as a temporary measure. Few politicians, not even the left-liberal Obama administration, really wanted to do it. They deemed it to be like changing a diaper: a dirty job, but one that had to be done considering the alternative.

And that was to let General Motors and Chrysler simply collapse, facing either liquidation or a reorganization that would have taken years, with potential permanent damage to the companies. While the feckless managements and the heedless union that produced these disasters surely deserved that fate, the rest of

America didn’t deserve to suffer the collateral damage to the economy that likely would have ensued.

Put another way, the economic consequences of the liquidation of GM and Chrysler when the U.S. economy was on its knees might have been unthinkable. Those consequences certainly were unknowable, but it would have been foolhardy to find out.

So in essence, the federal government financed and facilitated a fundamental restructuring of the auto industry. It is what private sources of capital would have done in ordinary times. But it’s critical to remember that nothing was ordinary in America in late 2008 and early 2009.

On Sunday, September 14, 2008, Merrill Lynch, the firm that had bought Wall Street to Main Street and had billed itself as “bullish on America,” agreed to be sold to Bank of America to avert financial collapse. Merrill was reeling from bad real-estate lending, and it was far from alone. Over the same weekend insurance giant American International Group begged for a $40 billion federal bailout because its mortgage-related lending, too, had gone awry.

Worse still, Lehman Brothers, a once high-flying investment bank burdened by similar bad debts, filed for bankruptcy and plummeted towards liquidation. This time the government declined to ride to the rescue, as it had done with AIG and, earlier in the year, with Bear Stearns. "The stunning series of events culminated a weekend of frantic around-the-clock negotiations, as Wall Street bankers huddled in meetings at the behest of Bush administration officials to try to avoid a downward spiral...," wrote *The New York Times.*

It was futile. The next day -- Monday, Sept. 15 -- the Dow Jones Industrial Average dropped 500 points. Two weeks later, after much congressional wrangling, President Bush signed the last major law of his presidency, the Troubled Asset Relief Program (TARP), to inject up to $700 billion into ailing banks to prop up confidence in the financial system.

But by late October the stock market plunged another 3,000 points, a total of 30% in five weeks. It was worse than the Crash of '29, and wiped out billions of dollars of wealth that could have been used to buy vacations or clothes or...cars. Wall Street came to Main Street in disastrous fashion.

At the Ft. Lauderdale headquarters of AutoNation, the nation's largest car-dealership chain, CEO Mike Jackson pored over historical sales records, and was shocked by what he saw. No event since World War II -- not the JFK assassination, the attacks of 9-11 nor anything else -- had caused such a quick plunge in car sales as had Wall Street's weekend collapse.

For the first half of September, sales were running at an annual pace of 14 million vehicles, which wasn't great but was bearable. But from Sept. 15 onward the sales pace dropped another 30%, to under 10 million vehicles, the lowest level in nearly 30 years. Consumers were afraid to buy cars. Bankers were just as afraid to make loans. The car companies couldn't cut costs fast enough to keep up.

On November 5 Obama was elected president, prompting *The Onion*, a satirical newspaper, to declare: “Black Man Given Nation’s Worst Job.” A month later, as if in proof, the Labor Department said the U.S. economy had lost 533,000 jobs in November, the highest monthly drop in 34 years.

Also that month General Motors and Chrysler said they would run out of cash by the end of the year. Ford, which had mortgaged everything it had, including its iconic blue-oval corporate logo, said it probably could survive without government aid, but it wasn’t sure.

Things were scary. Ironically, even the Japanese, German and Korean companies that built cars in America worried about the outright collapse of GM and Chrysler. The reason: their demise would drag down the components companies that supply all the auto makers, and thus would cripple the U.S. operations of the foreign-owned car factories.

On Dec. 7, a special church service was held at the Greater Grace Temple Pentecostal Church on Detroit's northwest side. Three gleaming white SUVs – a Chevrolet Tahoe, a Ford Escape and a Chrysler Aspen – were parked like sacred icons at the altar.

It happened to be the 67th anniversary of Pearl Harbor, but the service wasn't to pray for deliverance from Japanese dive bombers or torpedo planes. Instead it was to beseech relief from Toyota Camrys and Honda Accords, whose wide popularity -- on top of America's financial crisis -- was a critical cause of Detroit's affliction.

A vice president of the United Auto Workers union led prayers and gave the worshipers a benediction for the occasion. "We have done all we can do in this union," he said, "so I'm going to turn it over to the Lord."

But it was the government, not God, that intervened. When Congress refused to approve bailout money for Detroit, President Bush diverted TARP dollars to keep General Motors and Chrysler afloat until Obama assumed the presidency. In late February 2009, when he was still settling into office, President Obama appointed an automotive task force to figure out what to do.

Its members were mostly Wall Street types from private-equity firms. Their jobs had been to buy under-performing companies, restructure them and sell them off -- which sometimes worked and sometimes didn't. They knew next to nothing about the auto industry.

When they delved into their task, what they learned wasn't pretty. Since the 1940s the Detroit auto industry had been dominated by a corporate oligopoly (GM, Ford and Chrysler) and a union oligopoly (the United Auto Workers union). The oligopoly-monopoly structure had begun to break apart in the 1970s and 1980s, when auto-imports surged and foreign companies began building assembly plants in America.

But slovenly habits and bad practices remained. Among them was the Jobs Bank. It had begun in the 1980s as a temporary layoff-insurance program. But it had evolved into an absurdity under which laid-off UAW members were paid 95% of their wages indefinitely not to work.

In a perverse but predictable twist, the Jobs Bank led to something called "inverse layoffs," which occurred when senior workers volunteered to be laid off, and thus bumped junior workers back onto the assembly line. After all, why should a worker with high seniority slave away building cars when workers with lower seniority collected virtually full pay for just sitting around? Such was the logic of Detroit's dysfunction.

The union bore plenty of blame for this. But so had managements that, for decades, had run factories with bathrooms that were segregated not by race but by rank, with separate facilities for salaried employees and hourly workers.

For years UAW members also had gold-plated health insurance that didn’t require co-pays or deductibles for doctor visits, like virtually all other Americans paid. Managements didn’t mind granting such benefits because salaried employees had gotten them too.

Only in late 2007 did the UAW give Detroit relief from blank-check health spending. The union agreed to let the companies establish health-care trusts (called Voluntary Beneficiary Employee Associations) that they would fund with fixed contributions. Union-appointed trustees would administer benefit levels, depending on what the trusts could afford. It was a long overdue change that came too late to save GM and Chrysler.

By then Detroit's car companies had a cost structure so bloated that they only made money on big trucks and SUVs, instead of on ordinary sedans and coupes. Their product lineups were like one-legged stools that was uniquely vulnerable to a surge in gasoline prices.

That's exactly what had occurred in late 2005 after Hurricane Katrina struck New Orleans and disrupted the Gulf Coast oil fields. General Motors lost $10.6 billion that year, even though industry-wide car sales were at a near-record high. The next year Ford lost even more money, a breath-taking $12.6 billion, even though the economy and car sales were strong.

Chrysler, meanwhile, had suffered from a decade of product-development neglect, first under the ownership of Germany's Daimler and then under a private-equity firm that bought the company in 2007.

All this gave the lie to the notion that Detroit's implosion in late 2008 was solely due to the nation's economic crisis. The companies had been bleeding billions years earlier, even during a strong economy. The question that faced President Obama’s task force was what to do with them.

Clues came from Ford. In late 2006, with its troubles manifestly mounting, the company had begun taking dramatic steps without government intervention. It recruited a new CEO from outside the company to replace Bill Ford Jr., a scion of the founding family. Because the Fords had super-voting shares that let them control the company, Bill Jr. had, in effect, chosen to fire himself, which took considerable humility and courage.

His successor, Alan Mulally, soon started selling iconic brands that Ford could no longer afford to maintain, including Jaguar and Land Rover. Mulally also made the decision to mortgage virtually everything Ford had -- taking out “the world’s largest home-improvement loan,” he explained.

While Ford had been zigging, General Motors had zagged. The company’s board stuck with its Chairman and CEO, Rick Wagoner, even though he had presided over $70 billion in losses since 2005. Wagoner, in turn, stubbornly stuck with the company’s lineup of eight different brands -- Cadillac, Buick, Pontiac, Chevrolet, Saab, Saturn, Hummer and GMC -- even though some had been unprofitable for decades, and though there was little difference among their various models.

Perhaps most dramatically, Wagoner had tried to offset GM's automotive losses by diversifying GMAC, its financial arm, into sub-prime mortgages, of all things. (No kidding.) GMAC's results had been spectacular in 2003 and 2004, but then had plunged when the housing market collapsed. By then Wagoner had sold 51% of GMAC, shedding some of the losses, but losing control of one of GM's crown jewels.

Given that record, on March 27, 2009, the auto task force asked for and received Wagoner's resignation as an implicit condition for a government bailout. Wagoner's ouster sparked little debate within the Obama administration (more on that below). The big debate was what to do about Chrysler.

While GM was deemed too big to fail, given the potential ripple effects on the entire U.S. economy, the administration was sharply divided about Chrysler. Several task force members argued that Chrysler's demise wouldn't have nearly the same catastrophic effect as GM's, and that Chrysler's disappearance might increase the chances for GM and Ford to survive. Others argued that Chrysler's disappearance would produce shock waves that the reeling U.S. economy couldn't easily withstand.

The two camps made their case on the evening of March 26 in a meeting in the White House's Roosevelt Room, presided over by President Obama himself.

In the end, the president gave the go-ahead to try to rescue Chrysler, partly to placate his supporters in the UAW. Elections do matter.

Events then moved quickly. The task force crafted a deal to put Chrysler under the management control of Fiat, which emerged as the high bidder even though it didn't offer any cash. Majority ownership went to an unsecured Chrysler creditor, the UAW's VEBA trust.

The U.S. and Canadian governments, as well as Fiat, took smaller stakes. Fiat pledged to contribute engine and product technology to the new company, in lieu of cash. Banks and hedge funds that held more than $7 billion of secured Chrysler debt recovered only about 25 cents on the dollar.

On April 30, 2009 Chrysler entered federal court in New York to seek reorganization under Chapter 11 of the bankruptcy laws. It emerged from bankruptcy on June 1, which happened to be the same day that General Motors filed its Chapter 11 petition.

The GM filing stated that the company's $172 billion of liabilities overwhelmed its $82 billion of assets. And that GM's $59.5 billion in stock-market value at the beginning of the 21st Century had shrunk to nearly nothing.

"There are no realistic alternatives" to bankruptcy, the filing added. "There are no merger partners, acquirers or investors willing and able to acquire GM's business...The transaction (bankruptcy) is the only realistic alternative for the company to avoid liquidation that would severely undermine the automotive industry."

It was all sadly and horribly true. General Motors had virtually invented the modern corporation -- with professional managers, as opposed to family founders, presiding over decentralized operations that were governed by central financial control. It had pioneered modern marketing, public relations and the hierarchy of brands that made automobiles vehicles for social mobility as well as physical mobility. It had set standards for everything from style and design to corporate health-care plans.

The company had come through two world wars and the Depression and had stood as the defining corporation of the Pax Americana that spanned the globe after World War II. But that very success had bred complacency, arrogance and hubris. It had fostered the isolation of executives who never had to shop for a car, and a union's transformation from protecting workers' rights to protecting their "right" to be paid indefinitely for not working.

Had GM's filing occurred a few years earlier, stock markets around the world would have collapsed in panic. But the day that it really did happen, the Dow Jones Industrial Average actually jumped 221 points.

The task force imposed terms on the companies that both of them should have adopted decades earlier. The Jobs Bank was abolished, along with "inverse layoffs." On the factory floors, hundreds of feather-bedding work rules and ridiculous job classifications, which strictly defined which workers could do what jobs, were wiped away.

GM had to shed unprofitable brands -- Saturn, Saab, Pontiac and Hummer -- just as Ford had done without government involvement. Chrysler's retired executives lost the right to get two free lease cars, every year, for life. UAW members were told that their health-care coverage, alas, would no longer cover Viagra. Some of the "sacrifices" were fundamental, others comic, but all were necessary.

America's 2009 automotive bailout has produced both myths and lessons, and I would offer four of the former and three of the latter. The first myth is that the Obama administration overreached in ousting Rick Wagoner as CEO of General Motors, because the government shouldn't hire and fire corporate executives.

But in any bankruptcy, the lenders and investors who provide the capital that allow a company to be restructured instead of liquidated insist on calling the shots on management. The U.S. government was both lender and investor, because no private financiers were willing to provide capital.

Wagoner had bet GM's future on SUVs and sub-prime mortgages, and had produced tens of billions in losses since becoming CEO in April 2000. Only the negligence of a do-nothing, hand-wringing board had allowed him to last so long. It would have been irresponsible for the government to repeat that mistake by injecting billions into GM without insisting on new management.

Myth No. 2 is that Chrysler's secured creditors were treated unfairly because their loans weren't repaid in full. But the creditors got far more than they would have received had Chrysler been liquidated, which is what would have happened without government intervention. In 2007 they had made reckless loans to a failing company, the equivalent of lending an individual $50,000 to buy a rickety used Dodge. When the car got wrecked, the creditors were lucky to recover anything.

The third myth, related to the second, is that the UAW "won" by getting 55% of Chrysler's stock for its VEBA trust. In truth, the union had lobbied the task force hard to have its $4 billion VEBA claim with Chrysler paid in cash instead of stock.

The union's leaders knew full-well that Chrysler stock might wind up being worthless, while cash had real value. They wanted to milk Chrysler, not to own it, and the task force was right to rebuff them.

Myth Four: that GM and Chrysler simply were victims of a national, indeed global, economic crisis. Then how does one explain their huge losses earlier in the decade, when the economy seemed strong? More to the point, how does one explain Ford? There was nothing inevitable about the bankruptcies of GM and Chrysler. They didn't have to happen.

As for lessons of the bailout, the following get my vote for the three most important:

• Problems denied and solutions delayed will result in a painful and costly day of reckoning.

• In corporate governance, the right people count more than the right structure.

• Appearances can be deceiving.

All three might sound blindingly obvious, but it's amazing how frequently they're ignored. That's especially true for the first lesson, about denial and delay.

Everybody knew it was ridiculous and unsustainable to pay workers indefinitely not to work, to keep brands such as Saturn and Saab that hardly ever made money, and to pay gold-plated pension and health-care benefits to employees. But all of these practices, paid for by mounting debt obligations, continued for decades in GM's and Chrysler's 30-year, slow-motion crash.

Yet there were plenty of warnings. A dramatic one came in a January 2006 speech by auto-industry veteran Jerome B. York, who represented the company's largest individual shareholder at the time, Kirk Kerkorian. Unless GM undertook drastic reforms "the unthinkable could happen" within 1,000 days, predicted York, who died last March. As things turned out he was just 30 days off.

The relevant question looking forward is whether the unthinkable—going broke—also could happen to America.

Everybody knows that we're running unsustainable federal deficits. And that Fannie Mae and Freddie Mac created financial sinkholes by helping lenders make mortgages to people who couldn't afford them. And that many states' public-employee pensions funds are hopelessly underfunded for the level of benefits they provide. And that shoveling more money into the public schools without insisting on structural reforms and accountability hasn't produced results and won't do so in the future.

Addressing these issues inevitably means enforcing spending discipline and standing up to public-employee unions in a way that GM failed to do with the UAW. Continued denial and delay will prove ruinous. To put it another way: America bailed out General Motors, but who will bail out America?

The second lesson is almost as important as the first, even though the term "corporate governance" sounds about as exciting as, well, "dental floss." But good governance is critical because it is private enterprise that creates capital and funds government (though few people in Washington seem to act like it). What happened at GM, in contrast to its crosstown rival Ford, is instructive.

On paper General Motors was a model of good corporate governance, while Ford was (and is) a disaster. Each super-voting Class B share, which only Ford family members can own, gets about 31 votes for every share of the Class A stock that non-family members own. And the Ford family gets veto power over any corporate merger or dissolution. This is about as democratic as elections in North Korea, except that nobody calls Bill Ford Jr. “Dear Leader.”

But the Ford board of directors and family came together in 2006 to seek a new CEO from outside the struggling company, even though that meant family scion Bill Jr. had to relinquish command. (He volunteered to do so and remains chairman, but not CEO.) Meanwhile the GM board, consisting of blue-chip outside directors who chose a “lead director” from their ranks, steadfastly backed an ineffective management from one disaster to another, and wrung its collective hands while the company ran out of cash. Some GM retirees dubbed the directors the “board of bystanders.”

Ford’s governance might be undemocratic. But at least it concentrates decision-making power in the hands of a few people with a significant emotional and financial stake in the company, and they proved willing to act. Absolutely no one on the General Motors board had either such stake, which helps explain why the directors did nothing.

GM’s current board—appointed by the company’s controlling shareholder, the U.S. government—has a handful of holdovers from the prior board. Maybe they aren’t bad people, but they surely showed judgement that was beyond bad. As the new GM prepares for an initial public offering of stock—so that the government can recoup the taxpayers’ investment—it will need credibility at the board level. The holdover directors should resign.

As for appearances versus facts, the GM bailout—along with the similar exercise at Chrysler—offers ample evidence. The understandable objection to bailouts is that they foster moral hazard, the willingness to act recklessly without fear of consequences. Yet the bailouts of these two companies had painful consequences aplenty for the major actors.

Shareholders of both companies got wiped out. Creditors took major hits, including those who held secured debt at Chrysler. Many workers and executives lost their jobs. Many dealers lost franchises. The Jobs Bank was abolished, albeit belatedly. So was no-cost health insurance.

All this seems plenty of pain to discourage future moral hazard. Letting the companies liquidate would have produced far more pain, of course, but much of it would have fallen on innocent bystanders—the ordinary citizens who participate in an economy that was crippled last spring.

The Obama administration tried to walk a fine line: doing enough for Detroit to protect the economy, but not doing so much to foster future irresponsible behavior. Limited-duration, reluctant intervention in private industry under extraordinary circumstances is different than a wholesale government power grab. Would that the Obama administration had showed similar restraint on health-care and financial-regulation overhaul, not to mention taxes.

The future is always uncertain in such a dynamic and competitive industry, but the burden rests squarely on Detroit to make the most of its second chance. The early signs are encouraging.

In the first half of 2010 Ford Motor earned $4.7 billion, putting it on track to exceed its record profits of 1999, and made inroads in paying down its debt. GM earned $2.2 billion and Chrysler basically broke even. All this has occurred even though the American economy remains very shaky, and industry-wide car sales remain near multi-decade lows.

For decades General Motors has been the company most resistant to change, but no more. Only one of GM's 15 top executives remains in place 18 months after the bailout. The company has had four different marketing chiefs during this period. Cadillac has had three different bosses. There have been three different PR chiefs.

And most dramatically, four different CEOs: Wagoner and Fritz Henderson, both insiders, and Ed Whitacre and Dan Akerson, both outsiders. Whitacre was recruited by Obama's auto task force as non-executive chairman, but he took the CEO's post himself after concluding that no insider could really change GM. At age 68 he decided to be a short-timer, and with the IPO approaching he recently turned the reins over to Akerson, who is 61.

Currently, half of GM's senior executives are under 50. Unfortunately that made them younger than the average Cadillac and Buick buyer. The company still has lots of remedial work to do to attract younger buyers to brands long damaged by quality gaffes and lackluster designs. GM has had a long history of confusing "comeback" with "victory," and its challenge now is to act like a company fighting for its life, or a new lease on life, which indeed it is.

Meanwhile, the global auto industry is changing radically. In 2009 China (which has been a rare bright spot for GM) overtook the U.S. as the world's largest auto market. In 2010 a Chinese car company called Geely bought Volvo from Ford. And Italian-American Chrysler, without a hint of irony, started airing television commercials showing British redcoats being routed by American patriots

-- mounting their attack in flag-waving Dodge Chargers. (At least, for once, a car commercial was entertaining.)

On top of all this, a GM-Toyota joint-venture factory in California was bought by Tesla, a new-age car company in Silicon Valley that makes a battery-powered hot rod costing more than $100,000. Another shuttered GM plant in Delaware was sold to Fisker, a high-tech car company that would use it to build high-priced hybrid sports cars.

Death and new life were occurring simultaneously in the aftermath of the automotive bailout. That's what happens every day in most sectors of the private economy.

Amid the uncertainty and upheaval, it's clear that no car company will dominate America like the GM of yore, with half the market to itself while others were left to divide the rest.

Instead, five or six different car companies each will have between 10% and 20% of the market, supplanting the Big Three with a Medium Six. The likeliest candidates are GM, Ford, Toyota, Honda, Fiat-Chrysler and Nissan. But Volkswagen or Hyundai could elbow their way into the group. Or perhaps, a few years on, a Chinese or an Indian car company.

Whatever their national origin, all auto makers will have to keep abreast of rapid technological change, making more gas-electric hybrids and perhaps eventually building cars powered by hydrogen fuel cells and other wonders.

There will be one constant in all this. Americans will still love their cars, and the freedom of mobility that they provide, be they GMs or Jeeps, Hondas or Hyundais, Toyotas or (maybe one day) Tatas. That much will not change.

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