The Philadelphia Inquirer

Posted: Sun, Feb. 26, 2012, 9:29 AM

Bailing out Detroit

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The government bailout of the U.S. auto industry was a success.

Without financial help from Uncle Sam, General Motors and Chrysler likely would not exist today. The American auto industry would be a shadow of its former self. And the U.S. economic recovery would be even more drawn out and frustrating than it has been.

Saving the automakers was distasteful, but necessary.

Rehashing this bit of history is timely on the eve of the Republican primary in Michigan, where the economy has long been tethered to the auto industry. The potential GOP nominees have all spoken out against the bailout, which the Obama administration helped engineer. Yet it is worth remembering that when the bailout was being debated three years ago, in the teeth of the Great Recession, it had bipartisan support. And it was the Bush administration that provided the first substantial chunk of financial aid to the industry.

Detroit's need for government assistance was partly its own fault. For years, the automakers had been using deep price discounts and cheap financing to support sales, instead of making the tough choices necessary for them to stay viable in the long run.

But the industry's predicament was not entirely of its own making. The broader U.S. economy was in free fall, demand for cars was weak, and the banking system's near-collapse made car loans scarce.

Federal financing helped GM and Chrysler use bankruptcy to restructure without shutting down. Companies in bankruptcy need credit to pay workers and suppliers while they reorganize. In normal times, such credit - called "debtor-in-possession financing" - is available at premium interest rates from banks and other private lenders. But in 2009, the financial system was on life support; no such credit was available, even to the best of borrowers. If GM and Chrysler had entered bankruptcy without government support, they may never have come out.

While Ford was in better shape, it shares many suppliers with GM and Chrysler. Their liquidation would have dragged many of those suppliers under, pulling Ford into bankruptcy as well. So it's no surprise that Ford strongly supported the government bailout of its competitors.

The Big Three U.S. automakers employed about 250,000 workers at the time, but their deep connections throughout the rest of the economy meant closer to 2.5 million jobs were at risk. A bankruptcy without government support could have cost as many as a million jobs at a time when we were already losing millions. The economy would have been shattered in Michigan and in other parts of the Midwest and South that rely heavily on vehicle manufacturing. And given the likely loss of auto dealerships across the country, it's not hyperbole to say that nearly every community in America could have been harmed.

Because the government acted to save the auto industry during the recession, the current economic recovery has been stronger than it would have been otherwise. The automakers themselves are doing very well, profitably selling cars at a rate of 14 million a year. Before the recession, they were losing money on annual sales of about 16 million.

After using bankruptcy to restructure and lower their costs, GM and Chrysler have been able to ramp up production and hiring. Nearly a fifth of the growth in the nation's output since the recession ended has been related to the auto industry's revival. While the industry still employs far fewer workers than it did before the recession, it was among the first to resume hiring, and it has been adding aggressively to its payrolls ever since. Michigan and the rest of the Midwest have seen one of the strongest regional recoveries in the nation. It's hard to see how that would be happening if not for the bailout.

Bailing out the automakers had some downsides. While taxpayers will get most of their money back, the government will likely sell its remaining GM stock before taxpayers are made completely whole.

The bankruptcy process was painful all around, but the government cushioned the financial blow to the unions at the expense of the automakers' bondholders, partly for political reasons. True, many bondholders were speculators looking to make quick profits, but changing the rules during the game isn't good policy. One reason U.S. households and businesses can borrow cheaply is that creditors feel confident that loan terms won't be changed. The way creditors were treated during the auto bailout arguably weakened that sense of safety.

Such concerns are valid, but they wouldn't have justified letting the automakers go under. Some bailout critics claim the automakers could have survived bankruptcy without government help. Maybe, but would it have been worth taking the chance? The American economy was in crisis. Only aggressive government action could set it right.

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