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Dust-Up

What was the point of bailing out GM?

Should the federal government have spent billions to prevent liquidation only to have GM eventually file for bankruptcy? Daniel J. Ikenson and Howard Wial debate.

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Today's topic: Should the U.S. government have spent billions to keep General Motors from liquidation only to eventually steer it to Bankruptcy Court?

An earlier bankruptcy would have saved taxpayers billions

Point: Daniel J. Ikenson

General Motors should have filed for Chapter 11 bankruptcy protection last fall, if not earlier. It was obvious in 2008 that GM was deep in the red, burning through cash, struggling to service debt, suffering steep sales declines, facing bleak prospects and failing to find new sources of capital.

In November, GM turned to the federal government for a bailout loan -- the one final alternative to bankruptcy. After a lot of discussion and some rich debate, Congress voted against a bailout, seemingly foreclosing all options except bankruptcy. But before GM could avail itself of bankruptcy protection, President Bush took the fateful decision of circumventing Congress and diverting $15.4 billion from Trouble Asset Relief Program funds to GM (in the chummy spirit of avoiding tough news around the holidays).

That was the original sin. George W. Bush is very much complicit in the nationalization of GM and the cascade of similar interventions that may follow. Had Bush not funded GM in December (under questionable authority, no less), the company probably would have filed for bankruptcy on Jan. 1, at which point prospective buyers, both foreign and domestic, would have surfaced and made bids for spin-off assets or equity stakes in the "New GM," just as is happening now.

Of course, a bankruptcy judge, acting in an apolitical environment, would have had to determine whether GM could emerge from Chapter 11 as a going concern. That determination might have necessitated different concessions from different stakeholders. For example, the United Auto Workers union might have had to accept real pay cuts (not just revamped work rules) and the secured bondholders might not have been strong-armed into taking pennies on their investment dollars. And, certainly, taxpayer resources would not have been tapped. Sure, there would have been plant closures, dealership terminations and jobs losses, just as there are under the current nationalization plan.

But the path we've taken, regrettably, goes through an expensive, political minefield. If GM emerges from bankruptcy organized and governed by the plan created by the Obama administration, it is impossible to see how free markets will have anything to do with the U.S. auto industry henceforth. With taxpayers on the hook for $50 billion (at a minimum), the administration will do whatever it has to -- including tilting the playing field with policies that induce consumers to buy GM, hamstring GM's competition or subsidize its costs -- for GM to succeed. Thus, $50 billion is a sum that is more likely to grow larger than it is to be repaid. It is also a sum that will serve as the rationalization for further government interventions on GM's behalf.

Thus, what's going to happen to Ford? With the government backing GM, will Ford's access to capital be compromised? Can it compete against an entity backed by an unrestrained national treasury? Or are there more government-sponsored bankruptcies in our future?

Daniel J. Ikenson is associate director of the Cato Institute's Center for Trade Policy Studies.

Don't expect bankruptcy to result in a better GM

Counterpoint: Howard Wial

Dan, I don't share your faith that the national interest would have been better served if GM had gone through an ordinary bankruptcy process. Without government funding to keep GM in business during a bankruptcy, the automaker wouldn't have been able to remain a going concern. GM would have been unable to obtain private loans to stay open during a long, drawn-out court proceeding. Its assets would eventually have been sold off piecemeal with auto suppliers throughout the nation forced to close as they lost GM business, and there most likely would not have been a "New GM" for a new owner to take over.

Although you paint a less devastating (but, I think, highly unrealistic) picture of what an ordinary bankruptcy could have looked like for GM, you seem to think its survival, or not, is a matter of national indifference. Here is where we disagree fundamentally. There are important national interests at stake in maintaining a healthy U.S. auto industry. It's difficult to see how those interests could be as well served without GM.

We need a healthy U.S. auto industry to design and build the next generation of fuel-efficient cars. Additionally, auto suppliers are crucial to innovation in American manufacturing as a whole (not just in the auto industry), and U.S. auto production is a key part of our national defense infrastructure.

Destroying the productive capacity of our largest U.S. auto manufacturer and forcing thousands of suppliers out of business wouldn't further these goals.

If GM had been liquidated, foreign-owned manufacturers in the U.S. might have picked up some of the slack. But they rely less heavily on U.S. suppliers than GM does, and they do most of their research and development in their home countries. Eventually, new U.S. car manufacturers might surface, but if we waited for that to happen without also keeping GM in business, the nation would have lost much of its auto production and design capacity and much of its manufacturing supply base.

I agree with you, Dan, that the government has chosen to travel down a risky path. I'll address the political risks on Friday, but for now I want to point out that there is a risk in using the bankruptcy process to help resolve GM's problems. Bankruptcy, even if prepackaged and managed by the federal government, is about cutting costs. But GM's biggest problems aren't costs -- and certainly not labor costs, which for GM make up less than 10% of the cost of a car. GM's big problems are quality and innovation. Bankruptcy courts aren't set up to solve those problems.

Worse, overemphasizing costs may make it harder for a restructured GM to focus on quality and innovation. Will a cost-obsessed management close so many plants and lay off so many engineers, designers and production workers that the company loses its ability to make better and more innovative cars? I hope not, but I can't be confident. Organizations that are good at cost-cutting usually aren't good at innovating or getting better at what they do. Navigating between the poles of cost-cutting and innovation may be the biggest obstacle on GM's road to recovery.

Howard Wial is director of the Brookings Institution's Metropolitan Economy Initiative.