

Testimony of Sean P. McAlinden, Ph.D.
Executive Vice President for Research and Chief Economist
Center for Automotive Research
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Good morning, Dr. Warren and distinguished panel. My name is Sean McAlinden. I am the Executive Vice President for Research and Chief Economist at the Center for Automotive Research (CAR), a 501(c)3 non-profit research organization located in Ann Arbor, Michigan. I welcome the opportunity to speak with you today on the subject of the U.S. Treasury Department's Automobile Industry Financing Program (AIFP).

The automotive industry has long been, and continues to be, one of the most important sectors in the U.S. economy. As of May 2009, the motor vehicle and parts manufacturing industries directly employed 547,500¹ workers in the United States; the domestic automakers employed 202,800² U.S. hourly and salary workers, as of February 2009. In January 2009, the international automakers employed 107,500 U.S.

¹ United States Department of Labor, Bureau of Labor Statistics, Current Employment Survey, Not Seasonally Adjusted, <http://www.bls.gov/ces> (retrieved July 20, 2009).

² CAR proprietary data provided by Chrysler, Ford and General Motors; excludes GMAC employees.

workers.³ The auto industry has one of the largest economic multipliers of any sector of the U.S. economy, and is sufficiently large that its growth or contraction can be detected by changes in the U.S. Gross Domestic Product. In many states, employment in automotive and automotive parts manufacturing ranks among the top three manufacturing industries.⁴

The Center for Automotive Research has carried out the majority of national-level automotive economic contribution studies completed in the United States since 1992.⁵ For detailed information on the model and methodologies CAR employs to estimate the economic impact of the automotive industry, I refer you to the studies themselves.

Twice in the past nine months, CAR has estimated the potential impacts of significant contractions in automotive employment and production as a result of the economic crisis in the United States. In November, CAR published a research memorandum entitled, “The Impact on the U.S. Economy of a Major Contraction of the Detroit Three Automakers.”⁶ In this report, we estimated that a full contraction of Detroit

³ The following international firms reported beginning of year employment to CAR: BMW, Honda, Hyundai, Kia, Mazda, Mercedes, Mitsubishi, Nissan, Subaru, Suzuki, Toyota and Volkswagen.

⁴ Hill, Kim, Maranger Menk, D., Szakaly, S, **Contribution of the Motor Vehicle Supplier Sector to the Economies of the United States and its 50 States**, January 2007.

⁵ These studies include: The Center for Automotive Research. **Contribution of the Motor Vehicle Supplier Sector to the Economies of the United States and its 50 States**. Prepared for the Motor & Equipment Manufacturers Association, Ann Arbor, January, 2007. The Center for Automotive Research. **Contribution of Toyota to the Economies of Fourteen States and the United States in 2003**. Prepared for Toyota Motor North America, Inc., Ann Arbor, June, 2005. Institute of Labor and Industrial Relations, University of Michigan and the Center for Automotive Research. **Contribution of the U.S. Motor Vehicle Industry to the Economies of the United States, California, New York, and New Jersey in 2003**. Prepared for the Alliance of Automobile Manufacturers, Inc., Ann Arbor, May, 2004. Institute of Labor and Industrial Relations and the Office for the Study of Automotive Transportation, University of Michigan and the Center for Automotive Research. **Contribution of the Automotive Industry to the U.S. Economy in 1998: The Nation and Its Fifty States**. A Study Prepared for the Alliance of Automobile Manufacturers, Inc. and the Association of International Automobile Manufacturers, Inc. Ann Arbor, Winter 2001. The Office for the Study of Automotive Transportation, Transportation Research Institute, and the Institute of Labor and Industrial Relations, University of Michigan. **The Contribution of the International Auto Sector to the U.S. Economy**. A study prepared for the Association of International Automobile Manufacturers, Inc., Ann Arbor, March, 1998. McAlinden, Sean P., et. al., **Economic Contribution of the Automotive Industry to the U.S. Economy – An Update – A Study Prepared for the Alliance of Automobile Manufacturers**, Center for Automotive Research. Ann Arbor, Fall 2003. Office for the Study of automotive Transportation, **Competitive survival: Private Initiatives, Public Policy and the North American Automotive Industry** – Prepared for the U.S.-Canada automotive Select Panel. University of Michigan Transportation Research Institute, Ann Arbor, June, 1992. Most of these reports can be downloaded from <http://www.cargroup.org/publications>. The research staff of the Center for Automotive Research performed a number of these studies when located at the University of Michigan’s Office for the Study of Automotive Transportation; these papers can be downloaded from <http://deepblue.lib.umich.edu>

⁶ McAlinden, S. P., Dziczek, K, Maranger Menk, D., **CAR Research Memorandum: The Impact on the U.S. Economy of a Major Contraction of the Detroit Three Automakers**. Center for Automotive Research, Ann Arbor, MI, November 4, 2008.

Three production⁷ could reduce U.S. employment by 3 million jobs within a year, and a partial contraction of Detroit Three production⁸ could result in a loss of 2.5 million jobs in the first year.⁹

By May 2009, many of the jobs we estimated would be lost were indeed gone—over 144,700 direct jobs were lost in the U.S. motor vehicle assembly and parts industries between November 2008 and May 2009.¹⁰ The total employment impact was actually much higher, as additional job losses in other sectors can be attributed to both the indirect and expenditure-induced impacts of these declines in direct automotive employment.

In May, CAR produced a second research memorandum on the subject of automotive contraction, entitled, “The Impact on the U.S. Economy of Successful versus Unsuccessful Automaker Bankruptcies.”¹¹ At the time, Chrysler was in the midst of its bankruptcy case (which had begun on April 30, 2009) and General Motors was preparing to file its case on June 1, 2009. CAR examined what would be the short-term, economic cost of unsuccessful vs. successful bankruptcies of the two firms, compared to the public cost of generating a successful outcome for these companies.

The successful bankruptcy scenario included an assumption that the bankruptcy filings and settlements with debtors would be concluded in 60 to 90 days, as indeed, they were. It was also assumed that the court would approve a re-emergence plan with

⁷ “Full contraction” is defined as a short-term shock resulting in total collapse of the domestic automakers and a year where the international automakers were only able to operate at half capacity due parts shortages caused by a major wave of supplier bankruptcies.

⁸ “Partial contraction” is defined as a short-term shock from which all producers recover, with the domestic automakers returning to just half of their pre-shock production and employment levels.

⁹ McAlinden, Dzikczek, Maranger Menk, *op.cit.*

¹⁰ United States Department of Labor, Bureau of Labor Statistics, *op.cit.* Since the BLS publishes data by NAICS code, and not by company (each company has employment in both 31336100 and 31336300), it is not possible to compare this job loss figure to CAR’s estimate of nearly 240,000 direct jobs that could have been lost in a full collapse of the U.S. automotive industry.

¹¹ McAlinden, S. P., Maranger Menk, D., Cooper, A, **CAR Research Memorandum: The Impact on the U.S. Economy of Successful versus Unsuccessful Automaker Bankruptcies.** Center for Automotive Research, Ann Arbor, MI, May 26, 2008.

sufficient funding to create the new companies (in part, at least), with a new ownership structure, and that declines in employment and production would occur according to planned plant closures, as indicated in the filed corporate restructuring plans for each company.¹² In this “best case” scenario, it was assumed that the companies would enter and re-emerge from bankruptcy in a manner that would avoid escalating market share declines, and that sufficient financing would be available—not only for buyers of Chrysler and General Motors vehicles, but also for surviving dealerships to finance current and future inventory. Finally, we included an assumption that residual values for existing Chrysler and General Motors vehicles would not decline dramatically.¹³

In the case of unsuccessful bankruptcies of either Chrysler or General Motors (or both), employment and production was assumed to fall to 10 percent of pre-bankruptcy levels, overall U.S. automotive production would contract sharply as widespread disturbances of non-OEM parts suppliers took hold, market share would plummet and the residual values of existing Chrysler and General Motors vehicles would fall dramatically.¹⁴

The table below presents the estimated employment impacts under the two scenarios described above:

Table 1: U.S. Employment Impacts of Successful v. Unsuccessful Bankruptcies of Chrysler and GM

Employment	Scenario 1: Best Case		Scenario 2: Worst Case	
	End of 2009	End of 2010	End of 2009	End of 2010
Direct	9,700	29,000	203,800	82,700
Intermediate (Supplier ¹⁵)	24,000	69,600	480,700	160,100
Expenditure-Induced	29,500	80,800	659,500	203,900
TOTAL	63,200	179,400	1,344,000	446,700

¹² General Motors plan filed using SEC form S4 on April 27, 2009 and the Chrysler restructuring plan filed with the U.S. Bankruptcy Court for the Southern District of New York on April 30, 2009.

¹³ McAlinden, Maranger Menk, Cooper, *op.cit.*

¹⁴ *Ibid.*

¹⁵ Intermediate (Supplier) impacts include those for manufacturing and non-manufacturing firms.

Source: Center for Automotive Research

Even under the “best case,” which we are (arguably) currently experiencing with the rapid emergence of both companies from bankruptcy, CAR estimates the total employment impact of such planned, orderly and well executed bankruptcies would result in a loss of 63,200 total jobs in the U.S. economy by the end of this year. In 2010, the employment outlook remains negative in this scenario with 179,400 total jobs lost as plant closures continue to take hold across the country. The “worst case” scenario, which we appear to have avoided (hopefully), would have resulted in a loss of 1.3 million total jobs in the U.S. by the end of 2009, and nearly 447,000 total jobs by the end of the following year.¹⁶

The economic impact on personal income and tax revenues of the consolidation of Chrysler and General Motors through successful or unsuccessful bankruptcies is presented in the table below:

Table 2: U.S. Revenue Impacts of Successful v. Unsuccessful Bankruptcies of Chrysler and GM

Revenue Impact (billions)	Scenario 1: Best Case		Scenario 2: Worst Case	
	End of 2009	End of 2010	End of 2009	End of 2010
Personal Income	-3.4	-9.9	-68.7	-26.4
Increase in Transfer Payments	0.3	0.9	6.6	2.3
Social Security Receipts	-0.5	-1.3	-9.5	-2.5
Personal Income Taxes	-0.5	-1.6	-11.0	-4.2

Source: Center for Automotive Research

In the best case scenario, U.S. personal income falls by \$3.4 billion in the first year (2009). Given the assumption of a linear contraction, first year losses mount in the second year, leading to an additional loss of \$9.9 billion. In total, quick and successful bankruptcies by Chrysler and General Motors were projected to reduce U.S. personal

¹⁶ *Ibid.*

income by \$13.3 billion. By comparison, under the worst case scenario, personal income losses would total \$95.1 billion over two years, with the majority of this decline—\$68.7 billion—coming in the first year alone. The difference between these two outcomes represents an estimated \$81.8 billion in personal income loss avoided by a successful bankruptcy process for Chrysler and General Motors.

Though not reported in the personal income figure, additional losses to employees' supplemental earnings (including contributions to employees' pension and insurance funds) should be taken into account when considering the effects of a disruptive bankruptcy. Additionally, hospital and health systems could be negatively impacted as people lose their jobs and their employer-provided health insurance benefits.

Lost personal income affects local, state, and federal tax revenues and creates additional social program obligations. In CAR's model, transfer payments from government to individuals were projected to increase, and social security receipts and personal income taxes paid were expected to decline. The net impact of these three elements on the government balance sheet was projected to be \$5.1 billion over two years in the case of successful bankruptcies, and \$37.1 billion over the same time period had the Chrysler and General Motors bankruptcies failed—a difference of \$32 billion.¹⁷

Since workers in the automotive industry produce far higher output per hour, are generally paid higher wages, and possess higher healthcare benefits than workers in many other industrial sectors (such as textile or wood products) the rapid collapse of the

¹⁷ *Ibid.*

auto sector will have more serious and far-reaching effects than the collapse of other smaller, or less productive industries.

The operations of the domestic automotive industry and its supply base are heavily concentrated in the industrial Midwest states. In the May 2009 memorandum, CAR produced estimates of job loss by state for the successful and failed bankruptcy scenarios, and found that about half of the employment decline would occur in just five states. In the best case scenario, those states are Michigan, Tennessee, Ohio, Missouri and Indiana, which when combined represent an estimated 129,600 jobs lost, or 53.4 percent of the total U.S. employment decline. In the worst case scenario, the top five states are Michigan, Ohio, Indiana, Illinois and Texas, which when combined, represent an estimated 852,700 jobs lost, or 47.6 percent of the total U.S. employment decline.

The long-term benefits of a domestically owned automotive industry were not examined in CAR's two most recent memorandums on the economic significance of the industry. Such long-term benefits of a domestic U.S.-owned automotive sector include the maintenance of a viable, highly productive U.S. manufacturing sector; a price-competitive automotive market for consumers; the economic security of having an industry capable of developing and producing high technology/high fuel economy vehicles; and the many strategic national security considerations supported by the existence of a large domestic automotive industry.

The psychological impact of a complete collapse of Chrysler and General Motors on a struggling U.S. economy cannot be discounted by any serious economist. The sudden and total loss of these companies could cause an economy-wide loss of confidence or even panic, and would certainly result in a crisis in U.S. manufacturing

similar to the effect on the financial sector caused by the Lehman Brothers collapse. These “non-linear impacts” are beyond the forecast capabilities of the econometric model used by CAR.

In total, CAR estimates that the government intervention resulting in successful bankruptcies at Chrysler and General Motors avoided \$113.8 billion in additional personal income loss, government transfer payments and forgone social security and personal income tax receipts in the first two years, and more in succeeding years. Unsuccessful bankruptcies would have cost the U.S. economy far more than the \$113.8 billion figure in succeeding years.

The future viability of these companies following bankruptcy and reorganization will depend upon:

- Economic conditions overall and a significant, if not full, recovery of the automotive market, and additionally;
- A functioning financial sector that can provide adequate credit to automakers, suppliers, and the automotive consumer;
- Stability in the automotive supplier sector;
- The speed at which the companies are able to bring new product plans to market; and
- The final response of consumers to Chrysler’s and General Motors’ use of the bankruptcy process.

The federal government has successfully shepherded Chrysler and General Motors, GMAC, Chrysler Financial and countless suppliers and key lenders through a historic decline in the U.S. economy and in the automotive industry. I can find no

grounds for criticism for the actions taken by members of President Obama's Automotive Task Force—only grounds for the highest praise. Government, in the case of Chrysler and General Motors, was not the “lender of last resort,” it was the only resort. No other financing was available and no process other than bankruptcy could have led to such dramatic reductions in fixed costs that had crippled these companies for so long. Since the companies still had to pay the bondholders and the active and retired worker costs until the Section 363 sale was complete, the speed in which these court actions were executed was absolutely justified. A lingering or failed bankruptcy, as discussed earlier in this testimony, would have bled the companies to death by maintaining existing fixed costs and eroding their market value. Since March, the planning and actions of the automotive task force and the Chrysler and General Motors management teams can be labeled only as masterful and unprecedented by any fair industry observer.

The sacrifices that were made (and there were considerable concessions by all parties) were those that would have the greatest impact on lowering fixed costs. [A recent CITI Investment Research and Analysis publication estimated that the General Motors Company should reduce its North American fixed costs from \$10,363/unit in 2009 to \$5,419/unit in 2014—a \$5,000 savings per vehicle produced, and produce a positive EBIT as early as 2010].¹⁸

There has been a great deal of attention in the press on whether or not there was equity in the sacrifices of key stakeholders in the Chrysler and General Motors

¹⁸ Michaeli, Itay, **U.S. Autos & Auto Parts, Citi Auto Call Series – Focus on General Motors**, Citi Investment Research & Analysis, July 16, 2009.

bankruptcies. Equitable or not, I believe the sacrifices made were precisely the correct ones to achieve lower fixed costs for the companies.

In the case of Chrysler, the secured bondholders received \$2 billion cash on their \$6.9 billion stake, a 71 percent discount.¹⁹ Unsecured creditors received no stake in the restructured company; any recovery for this group of stakeholders must come from the sale of assets of the Old Chrysler.

Chrysler carried over \$18.3 billion in UAW retiree health care liabilities on its books in 2007. The UAW-Chrysler National Agreement signed in that year reduced the total liability to \$11.0 billion through the creation of a Voluntary Employee Beneficiary Association (VEBA) for retiree health care (among other concessions).²⁰ In the 2009 modifications to the VEBA for Chrysler workers, the UAW accepted 55 percent of the stock in the restructured Chrysler in lieu of half of the cash necessary to establish the trust.²¹ On the unsecured retiree health care liability alone, one might argue that the UAW received cash for just 30 percent of the original retiree health liability, a 70 percent hit even before one considers the plant closings and job cuts, second tier wage agreement, suspension of cost-of-living allowances, job security programs, or modifications to active health care, supplemental unemployment benefits, overtime and holidays which were agreed to in 2007 and 2009 negotiations.²²

At General Motors, bondholder claims amount to nearly 86 percent of total claims on the \$6.9 billion in calculated value of equity and warrants sold to the Old General Motors, for a total of \$5.9 billion. With total bond claims amounting to \$28.3 billion, the

¹⁹ **Supreme Court Order Delays Chrysler Sale to Fiat**, National Public Radio, July 21, 2009.

²⁰ **UAW Chrysler National Agreement**, October 29, 2007.

²¹ **UAW Chrysler Modifications to 2007 Agreement and Addendum to VEBA Agreement**, April 2009.

²² *Ibid.* and UAW-Chrysler National Agreement, *op.cit.*

expected bond recovery rate with the stake in the restructured General Motors will be 21 percent, representing a 79 percent discount.²³

The 2005 UAW VEBA at General Motors reduced the overall \$60 billion hourly retiree health care liability by 25 percent.²⁴ In 2007, the parties agreed to total VEBA funding of \$31.9 billion, which represents a further 32 percent discount on the remaining liabilities of \$46.7 billion.²⁵ With the 2009 modifications to the UAW-General Motors agreement, the UAW agreed to accept a 17.5 percent stake in the restructured company in lieu of half of the cash pledged to fund the VEBA.²⁶ At General Motors, the UAW VEBA received just 27 percent in cash on their total 2005 hourly health care claims of \$60 billion, representing a 73 percent discount in this area. As is the case with Chrysler, the UAW also accepted significant additional concessions for active members and new hires which would bring the union's total sacrifice to a much higher total.

It is worth noting that, while the relative sacrifices of the debt holders and the UAW's VEBA trusts are comparable in the 67 to 79 percent range, the UAW made a far greater contribution in absolute dollar terms to the debt reduction at Chrysler and General Motors. At Chrysler, the UAW's \$12.8 billion cut is three and a half times the size of the secured debt holders' contribution, and at General Motors, the UAW's \$43.8 billion sacrifice is nearly twice that of the bond holders.

As the federal government moves into a role of oversight and guardianship of the federal investment in Chrysler and General Motors, it is appropriate to set broad targets for various business outcomes, such as financial and operational performance metrics and the share of global capital expenditures allocated to North American investments. It

²³ Bansal, Chetan, **GM Bond Recovery: Owning pre-IPO equity in Newco**, CITI Investment Research & Analysis, July 16, 2009.

²⁴ **UAW-General Motors Report**, October 2005.

²⁵ **UAW-General Motors National Agreement**, September 26, 2007.

²⁶ **UAW General Motors Modifications to 2007 Agreement and Addendum to VEBA Agreement**, May 2009.

should be expected that the directors appointed to the Chrysler and General Motors boards by the government will work towards setting these targets, in the interests of U.S. and Canadian taxpayers.

However, there are four broad areas of the automotive business in which the government should refrain from getting involved: product selection and timing; supplier selection; the selection of research and development initiatives and investment; and the general area of detailed management oversight and attempts to initiate so-called “cultural change.” Government intervention in these domains will restrict management flexibility to respond to market and, at the very least, slow the decision process so necessary to the operation of successful automotive firms.

It is impossible to know, with complete certainty, what the counterfactual outcome would have been had the government not extended its use of TARP funding to the automotive industry. I believe that, absent this critical lifeline from the federal government, there would be no domestic automotive industry to speak of going forward, and that this would have catastrophic results for the overall U.S. economy. In addition, the geographical concentration of much of the domestic industry in primarily one region of the country, the industrial Midwest, would concentrate much of the impact in areas already hardest hit by the economic downturn

The new Chrysler and General Motors face three significant future challenges. First, an economic recovery must take hold quickly in order for the vehicle market to rebound and for Chrysler and General Motors to begin their move back toward profitability and independence from government involvement. The timing of the recovery is essential, as automotive sales must increase while the two companies still have

sufficient operating cash. A double-dip recession could derail efforts underway to rebuild these companies in many areas. Second, if these companies struggle or falter in their recoveries, this will heighten the risk exposure of the union and the bondholders who took equity stakes in exchange for their liabilities in the old companies. In the case of the UAW, it could impact the level of benefits offered to retirees through the VEBA trust, and have wider impacts on the health sector in the industrial Midwest—and potentially, for government-backed health programs more broadly. Third, it remains to be seen if consumers can and will forgive Chrysler and General Motors for their trip through bankruptcy and restructuring and return to the vehicle showrooms in sufficient numbers to restore confidence in the brands and products offered.