The New GM: Government Made

These days, Saab happens to be a GM subsidiary, but no matter: the maker of oddly styled but reliable sedans is on the verge of bankruptcy, an event that would throw large numbers of Swedes out of work. GM, saddled with troubles enough domestically, has demanded that Stockholm bail out Saab, but the Swedish government has refused, tartly advising GM and other interested parties that Sweden is not in the business of purchasing automobile companies. Saab is now in the process of negotiating a restructuring deal with creditors, and thousands of Swedes employed in the automotive sector are holding their breaths.

Would that Washington politicos — ostensible champions of free-market capitalism — showed as much restraint in this instance as the socialist Swedes. But in the land of free-market risk and reward, some, it turns out, are entitled to reward without exposure to the risk of failure. That, at least, is the message the Obama administration (and before it, the Bush administration) has been sending loud and clear for months. Millions of Americans forced to accept the bitter consequences of foolish and excessive debt for houses and other things they could not afford could only watch and wonder as Washington extended GM (and Chrysler) a multibillion dollar lifeline, trying to save the automotive giant from itself despite the cost to present and future taxpayers.

Spectacular Fall

GM's fall has been nothing short of spectacular. The 100-year-old corporation, one of the best-performing stocks in the great bull market of the Roaring Twenties, has gone in a few short years from an American icon to the verge of collapse, courtesy of a bubble economy that deceived wiser souls than the decision makers at GM. Automobile manufacturers, after all, are not expected to be experts in high finance or to understand the arcana of Federal Reserve policymaking and monetary policy that created the artificial decades-long boom. All they knew was that Americans, flush with boom-time cash, wanted their cars large and brash.

When the bottom fell out of the economy, Americans suddenly discovered they did not need SUVs the size of troop transporters or three spanking new cars per household. GM and many other automakers were left with enormous inventories and lines of production that were suddenly losing money. Such things always happen when financial bubbles burst, and this time around, the entire automotive sector was caught flat-footed.

But those are the hazards of corporate America, especially in a sector like automobiles where a privileged few (in this case, the Big Three) have enjoyed special favors and a quid-pro-quo relationship with Washington insiders for decades.

Since late 2007, when GM share prices were between $40 and $45, the company's valuation has plummeted to practically nothing, with GM shares now barely above $2 (levels not seen since the Korean War) and expected by analysts to fall below $1 soon — if the company survives at all.

Accordingly, GM executives went to Washington last fall, hats in hand, to beg for subsidies to keep them afloat. General Motors was too large to fail, they argued; GM's demise would create tens of thousands of unemployed and bring the automotive industry to a standstill. American taxpayers were outraged when the Bush administration extended GM and Chrysler bridge loans amounting to $13.4 billion, using TARP funds.

But the bailout game is not a one-way street. The famous dictum of American-style socialism, first articulated in the Supreme Court's decision in *Wickard v. Filburn*, is that government is entitled to "regulate that which it subsidizes." In other words: feed at the government troughs if you wish, but do not be surprised when the government keeps you locked in the corral.

As GM has now found out, the Obama administration takes its de facto ownership of the largest U.S. automaker seriously. On March 29, GM Chairman and CEO Rick Wagoner was in effect fired by the Obama administration as part of a federally mandated restructuring plan. This was followed by the almost unbelievable promise that the federal government would guarantee all GM car warranties, an obligation that could potentially cost American taxpayers billions of dollars more. Finally, President Obama gave GM 60 more days to mend its ways, or be allowed to go bankrupt (Chrysler, meanwhile, has been given a mere 30 days to consummate a merger with Italian automaker Fiat). Should either or both corporations meet these unlikely goals, more federal billions may be in the offing. Otherwise, GM and Chrysler, and the tens of billions of taxpayer dollars spent on them, will likely be lost forever.

The Obama administration's newfound toughness is traceable in large measure to public furor over bonuses and other misuse of taxpayer billions at AIG. The stick-and-carrot approach being used with automakers is being touted as the right way to do bailouts by the likes of *U.S. News & World Report*. "The government should be taking the same tough approach toward banks and financial firms that it has toward Detroit," *U.S. News* enthused. Applying the lessons of GM and Chrysler to the banking sector would require the Feds to "assign deadlines" and "require progress reports," among other things, for ailing banks and financials, instead of churning out bailout monies without accountability.

Crossing the Nationalization Rubicon

This is the kind of argument we're likely to hear more of in coming months. In essence, it's a plea for the federal government to drop the façade of benefactor and assume outright ownership of the corporations it keeps afloat. With ailing banks, the government has already purchased gobs of preferred stock, crossing the nationalization Rubicon in everything but name. Who truly believes that, having thusly seized private assets, the federal government will ever voluntarily relinquish them?

But all such arguments obscure the neglected, and only correct, alternative: leave private corporations, large and small, alone, to succeed or fail as market forces dictate. The unpleasant truth about most of the corporations that have received federal bailout monies, GM and Chrysler included, is that they will likely fail anyway. Most of the hundreds of billions shoveled into AIG were promptly sent off to creditor institutions, paying down some of AIG's debt but doing little to address institutional and balance-sheet problems. While GM has made some effort at restructuring, the government loans are very likely to prove too little, too late; certainly GM's share price anticipates such an outcome.

And what will the politicians say when GM, AIG, Chrysler, and many more banks that have suckled from the federal teat go bankrupt anyway, defaulting on the repayment of U.S. government loans into the bargain? The consequence will be that bankruptcy will affect not merely the shareholders and employees of GM and the rest, but also every U.S. taxpayer, who will be left — as he always is — holding the empty bag. Bailouts will have served only to exacerbate the hardship of recession.

As with nearly every other action the Bush and Obama administrations have taken to fight the recession, the bailout and subsequent takeover of GM is flagrantly unconstitutional. Nowhere in the Constitution is Congress given the authority to bail out ailing firms, and nowhere is the president or even the Supreme Court granted similar powers.

What will the bankruptcy of GM, all but inevitable now, likely entail? In the short run, to be sure, more unemployment and hardship, although no more than has been experienced by the millions already out of work in the United States. But in the longer run — years rather than months — those who buy up GM's assets will reactivate idled plants, rehire laid-off workers, and revive the U.S. auto industry in more profitable form. This would probably have happened already, had the government chosen not to intervene.

GM and the rest of the Big Three have long operated on the assumption that, no matter how bad things got, the U.S. government could be depended upon to bail them out. This, after all, is what the Carter administration did for Lee Iacocca's Chrysler. While Chrysler's bailout-enabled turnaround made the move seem like the right thing to do, it encouraged moral hazard in the auto sector. Little wonder that GM over the years has allowed itself to grow into an unwieldy bureaucracy slow to innovate and reluctant to change; its management and shareholders cling to the cherished illusion that the government will protect them from the consequences of poor decision making.

As a crowning irony, Saab may well outlive her onetime benefactor. Perhaps motivated by the knowledge that no subsidies are forthcoming, Saab appears to be about to turn the corner, thanks to accommodating creditors, although the outcome is still in doubt. But there's no question GM could do worse than follow Saab's example.

It's only a pity that Washington, in this instance, has proven unwilling to follow Stockholm's example.

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