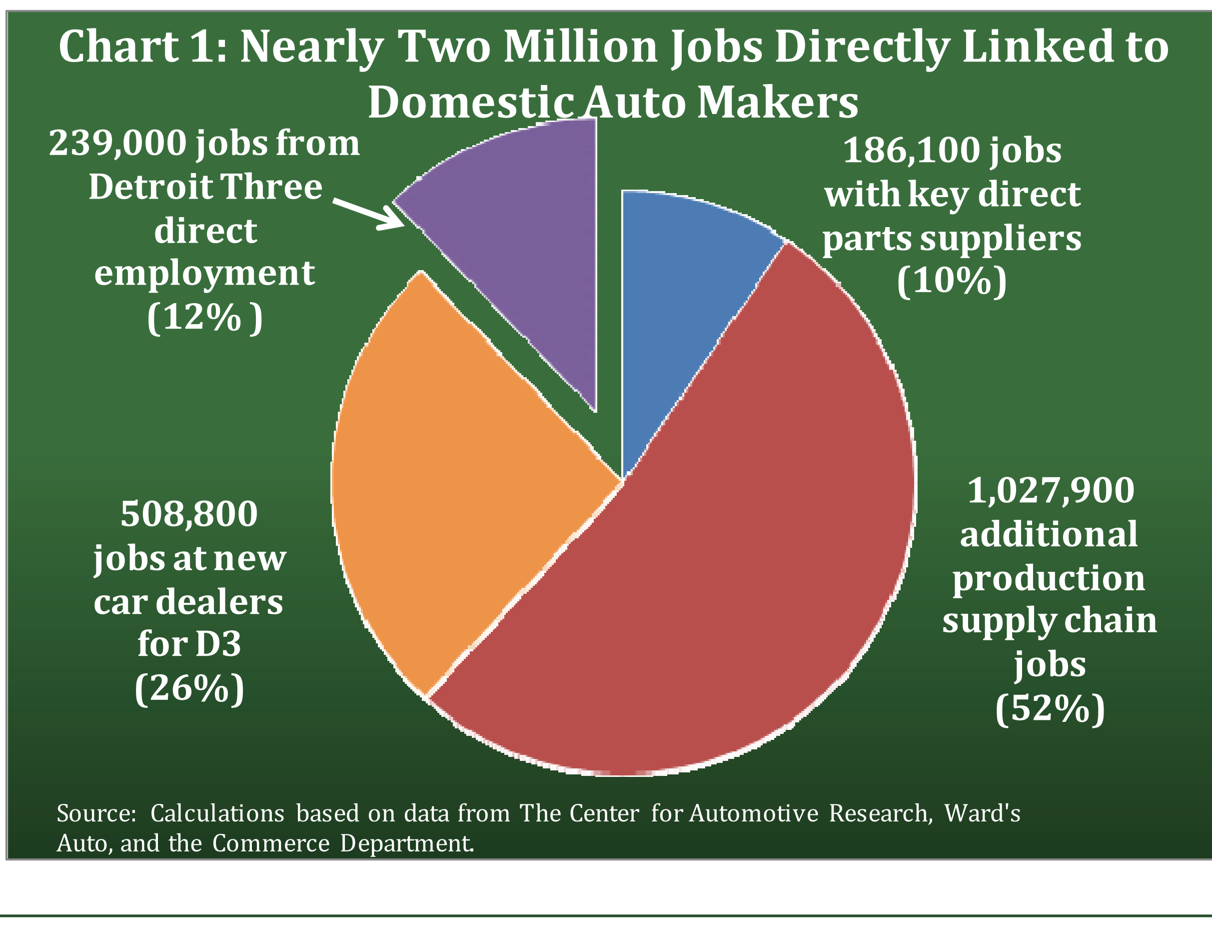
THE RIPPLE EFFECT: WHY FAILURE OF THE BIG 3 IS NOT AN OPTION

The Auto Industry Employs One in Ten Manufacturing Jobs

The domestic vehicle manufacturing industry, including the numerous companies that manufacture parts and technologies to supply American automakers, represents over 10 percent of the nation's manufacturing employment. A major contraction or collapse of the domestic auto industry could have multiple adverse affects on the economy, especially by driving up unemployment. Serious jobs losses in the industry would also have negative spillover effects for the manufacturers that supply everything from tires to cutting edge advanced technology such as advanced batteries for hybrid vehicles. These spillover effects would harm future innovation in the United States broadly, not just in the auto sector. Finally, over 10 percent of U.S. exports are motor vehicles or parts, and an additional 39 percent of exports are from capital goods sectors such as industrial machinery that depend in part on supplying domestic automakers.[1] For this reason, a major failure of U.S. automakers will have an immediate and severe negative effect on our trade deficit, and will make any future progress on improving our trade balance far more difficult.

Approximately 2 Million Workers Build or Sell Vehicles Made by the Detroit Three

Chart 1 shows a breakdown of the estimated employment that depends directly on the Detroit Three, based on data from the Department of Commerce.[2] The production supply chain alone relies on almost 1.5 million workers, far more than the quarter million workers who are directly employed by the automakers. This is because most of the workers who produce a car work for outside suppliers who manufacture vehicle parts and components. In addition, vehicle parts suppliers must themselves draw on producer s of other supplies and services, ranging from steel to machine tools. The Commerce Department's Bureau of Economic Analysis estimates that each job in auto assembly and parts production directly supports 2.4 additional jobs in the economy through its supply chain purchases.



Once the car is produced, it is sold and serviced through auto dealerships that employ over a million workers, approximately half of which sell Detroit Three cars. In total, almost two million workers are directly employed in the production and sale of Detroit vehicles. Only 12 percent of these jobs are in the Detroit automakers themselves, but all of them could potentially be threatened by an automaker shutdown.

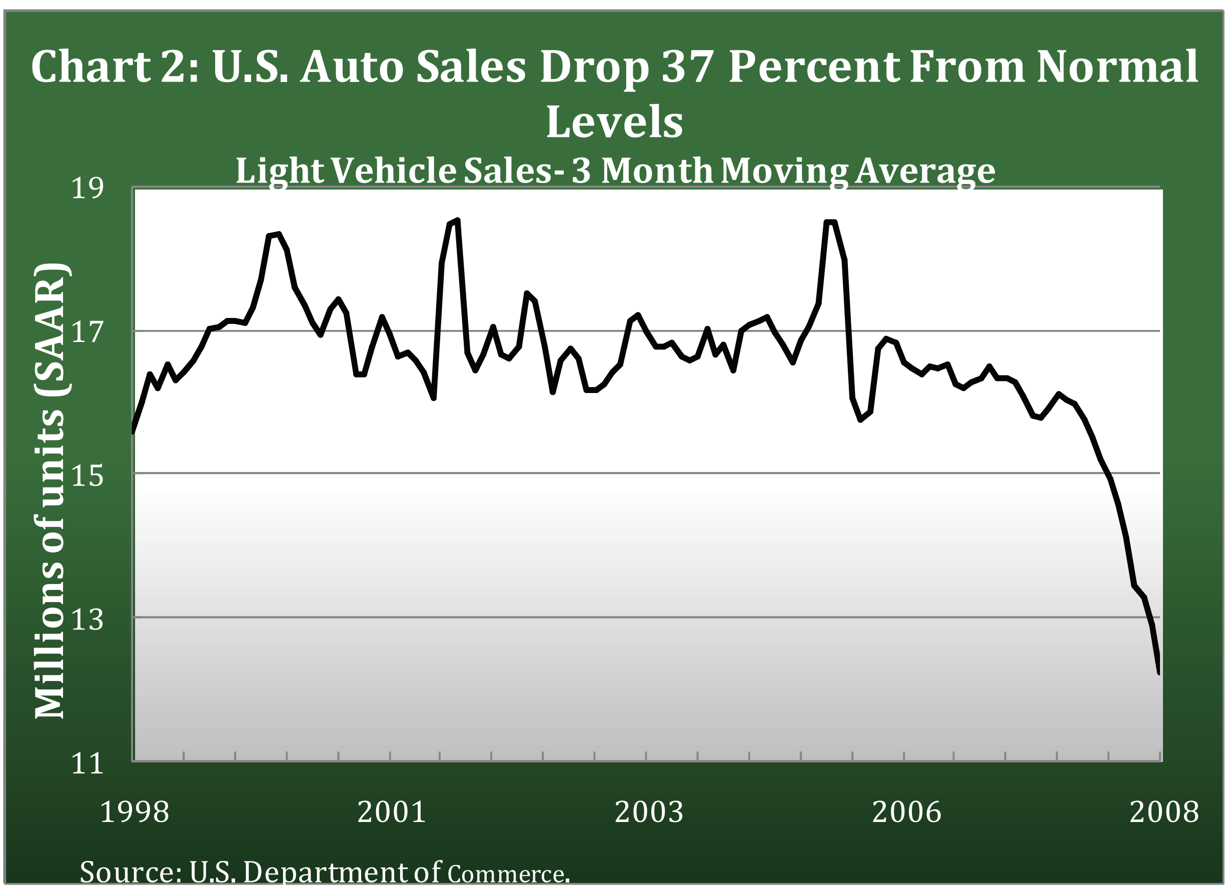
Multiple Studies Estimate Job Losses of 2.5 Million or More from a Major Automaker Contraction

The two million workers connected to the Detroit Three indirectly support many other jobs. Job loss among auto workers would reduce spending in their communities, leading to further job losses in retail and other sectors. At a time of general recession, the job and consumer expenditure losses created by a major auto industry contraction will not be made up from other sources.

The exact number of jobs supported by this spending is difficult to estimate. However, it is clear that numerous additional jobs would be at risk. Three separate studies – from Mark Zandi of the economic analysis firm Moody's Economy.com, the Center for Automotive Research, and the Economic Policy Institute – have estimated that a major disruption to the auto industry would lead to job losses of at least 2.5 million and possibly as much as 3 million jobs.[3] This implies that a major contraction or collapse of the domestic auto industry could singlehandedly drive the unemployment rate from its current level of 6.7 percent to 8.3 percent, even as job losses in other sectors continue.

The Current Financial Automaker Crisis Is Exacerbated By the Credit Crisis

The magnitude of these losses were driven by the combination of a massive spike in crude oil and gasoline prices during 2006-07, followed by the credit crisis and recession that has begun over the past year. The credit crisis has led to a sharp cutoff in financing for auto loans, and the general impact of the recession has led to record drops in consumer spending. **Chart 2** shows the combination of these two factors has devastated North American vehicle sales for all manufacturers. Total vehicle sales in November 2008 were down 37 percent from one year ago. Once recovery has begun from the credit crisis and the recession, it is likely that automaker earnings and sales will begin to show a recovery as well.



American Automakers Have Already Made Major Progress on Needed Restructuring

In 1990, MIT researchers estimated that Toyota and other Japanese "lean manufacturers" were twice as efficient as the U.S. "Big Three", and could manufacture a car in one-half the time required by American firms.[4] Today, the most recent data finds that U.S. manufacturers have "nearly erased the productivity deficit against their Japanese-based competitors".[5] General Motors has increased its productivity 15 consecutive years, and now requires 32.3 hours to manufacture a car, as opposed to 30.7 hours for industry leader Toyota – a productivity gap of only about 5 percent. Chrysler has now tied Toyota in productivity.

GM and other Detroit manufacturers have also made major recent investments in improving fuel efficiency, to avoid a repeat of sales declines associated with rising gas prices. General Motor's 2008 model line has more vehicles with 30 or more miles per gallon than any other manufacturer, and the company plans the introduction of 16 new hybrid vehicles by 2010.[6]

Auto Worker Pay and Benefits Have Already Been Slashed To Competitive Levels

A major reason for cost difference between Detroit and Japanese automakers is that U.S. firms must assume additional pension and retiree health costs not faced by foreign manufacturers. However, in 2005 and 2007 the United Auto Workers (UAW) made major concessions in pay and benefits. The new contract slashed starting salaries at auto plants by 50 percent, to about $14 per hour. Current UAW workers also sacrificed all wage increases from 2006 through the end of the contract in 2011.[7] Most important of all, the new contract established a health care trust fund that cut retiree pension and health benefits significantly. For example, the new contract will cut GM's total legacy pension and health benefits from $7 billion to approximately $1 billion beginning in 2010, and cuts Ford's legacy-related costs from $16 to $3 per current labor hour.[8]

The frequently cited figure that UAW autoworkers make over $70 per hour is inaccurate, and is based on representing the full fixed costs of retiree health and benefits as part of labor costs for the current, much smaller automaker workforce. In fact, the most highly paid UAW worker at a Detroit Three automaker, a skilled trades worker with seniority, earns about $33 per hour.[9] The new labor agreement cuts full labor costs, including all current and legacy benefit costs, to $53 per hour for U.S. automakers, as compared to $49 per hour at non-unionized Honda and Toyota assembly plants.[10]

Standard Bankruptcy Is Not a Viable Solution for Troubled Automakers

Companies in bankruptcy restructuring are dependent on external financing to continue operation. In the current credit crisis, it is highly unlikely that private sector external financing will be forthcoming for GM or other automakers that enter bankruptcy. Without private sector financing, a standard Chapter 11 process could quickly result in a movement to Chapter 7 liquidation, potentially resulting in the large-scale job losses outlined above.

It is also important to note that the bankruptcy process is designed to pay off creditors, not to protect the public interest. During the bankruptcy process, firm management would be unable to undertake major new initiatives to improve technology, fuel efficiency, or productivity, since their attention would be engaged by legal conflicts over finances. Finally, consumers are unlikely to purchase automobiles from a bankrupt manufacturer, due to concerns over warranties and service.

A Conditional Bridge Loan from the Federal Government Is the Right Step

The American auto industry is under tremendous financial pressure from a unique set of economic circumstances. If one or more auto manufacturers go out of business at this time, then the total costs to society will be far greater than loan that has been requested from government. The study by the Center for Automotive Research found that a 50 percent contraction in Detroit automaker employment would cause government to lose $50 billion in the first year and $108 billion over three years due to combined declines in tax receipts and increases in transfer payments.[11]

Bridge financing would be crucial in helping these companies past the current credit and economic crisis, until recent improvements in productivity and fuel efficiency pay off. Any bridge financing should be accompanied by strict oversight and conditions for investment in continued progress in improving efficiency, as well as further stakeholder concessions.

ENDNOTES

[1] *International Trade in Goods and Services: September 2008*. U.S. Department of Commerce. Bureau of Economic Analysis. Exhibit 6. 13 November 2008. Available at: http://www.census.gov/foreign-trade/Press-Release/current_press_release/ft900.pdf; Accessed: 12/8/2008.

[2] These estimates were based on a number of sources, including Center for Automotive Research data on current direct automaker employment. BLS data on employment in the auto parts sector (NAICS 3363) was then added to this direct employment, after being adjusted downward for auto parts workers already employed by the automakers, parts workers employed in manufacturing after-market parts, and an estimate of the number of parts workers who supply foreign-owned carmakers. The resulting jobs totals were then multiplied by an estimate from the most recent Bureau of Economic Analysis RIMS II input-output model of the number of additional supply chain workers associated with each job in vehicle parts manufacturing and assembly. Retail employment was estimated by taking BLS data on employment among new car dealers (NAICS 44111) and dividing in proportion to Detroit Three sales.

[3] Cole, David, Sean McAlinden, Kristen Dziczek, and Debra Maranger Menk. *CAR Research Memorandum: The Impact on the U.S. Economy of a Major Contraction of the Detroit Three Automakers.* Center for Automotive Research. 4 November 2008. Available at: http://www.cargroup.org/documents/FINALDetroitThreeContractionImpact_3__000.pdf; Accessed: 12/8/2008.

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[4] Jones, Daniel T., Daniel Roos, and James P. Womack. *The Machine that Changed the World: The Story of Lean Production.* Harper Perennial. November 1991.

[5] Gardner, Greg and Michelle Hill. *Lean Improvements, Worker Buyouts Bring Detroit Three Productivity Closer to Asian Rivals.* Oliver Wyman. 5 June 2008. Available at: http://www.oliverwyman.com/content_images/OW_EN_Automotive_Press_2008_HarbourReport08.pdf; Accessed: 12/8/2008.

[6] 2007 *Annual Report.* General Motors. Available at: http://www.gm.com/corporate/investor_information/stockholder_info/; Accessed: 12/8/2008.

[7] Gettelfinger, Ron. Statement to the U.S. Senate Committee on Banking, Housing and Urban Affairs. *The State of the Domestic Auto Industry: Part II,* Hearing, December 4, 2008. Available at: http://banking.senate.gov/public/_files/GettelfingerSenateTestimony12408.pdf; Accessed: 12/8/2008

[8] 2007 *Annual Report.* General Motors. Pg. 8. Available at: http://www.gm.com/corporate/investor_information/docs/fin_data/gm07ar/download/gm07ar_full.pdf; Accessed: 12/8/2008.

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[9] *The Truth about UAW Members and the U.S. Auto Industry*. The United Auto Workers Union. 1 December 2008. Available at: http://www.uaw.org/auto/pdf/UAW%20Q%20and%20A%202.pdf; Accessed: 12/8/2008.

[10] Mulally, Allen. Statement to the U.S. Senate Committee on Banking, Housing, and Urban Affairs. *The State of the Domestic Auto Industry: Part* II, Hearing, December 4, 2008 (Appendix Slide 2). Available at: http://banking.senate.gov/public/_files/Brfg12308AutoCongressionalSubmissionAppendix.pdf; Accessed: 12/8/2008.

[11] Cole, David, Sean McAlinden, Kristen Dziczek, and Debra Maranger Menk. *CAR Research Memorandum: The Impact on the U.S. Economy of a Major Contraction of the Detroit Three Automakers.* Center for Automotive Research. 4 November 2008. Available at: http://www.cargroup.org/documents/FINALDetroitThreeContractionImpact_3__000.pdf; Accessed: 12/8/2008.