Testimony of Felix G. Rohatyn to the House Financial Services Committee
December 5, 2008

Mr. Chairman and members of the Committee:

I am pleased to accept your invitation to review the present situation of the auto industry with you. General Motors, Ford and Chrysler are all in serious jeopardy. The situation is fraught with danger and each of your options carries its own risks. The situation is in some ways similar to the near bankruptcy of New York City in 1975, as well as that of Chrysler in 1980.

After years of operating losses as well as a heavy burden of accumulated legacy costs, GM together with Ford and Chrysler – like New York City thirty years ago – are facing bankruptcy unless the US government is willing to provide them with multi-billion dollar loans. The loans would not guarantee the success of a restructuring but the companies have each submitted a different plan which is intended to bring them to profitability. Absent the loans, however, the companies are likely to fail in time, with serious consequences to our fragile economy.

Government loans, of this type are emergency instruments but have been used in some critical cases with success. Sustained profitability has to be the objective. In May, 1975, New York City was also headed for bankruptcy. Years of operating deficits, failure to make capital investments, high taxes and high costs were driving businesses and residents out of the city. The banks, which normally financed the city, refused to renew their loans absent major reform and Governor Carey and Mayor Beame requested an emergency loan of $1 billion from Washington to tide the city over its next loan maturity. When President Ford refused the request, the city was faced with grim alternatives: either declare bankruptcy or submit New York City to a combination of steep tax increases and brutal budget cuts, which would leave the city in a desperate economic position and with social problems of unknown dimensions. Governor Carey, Mayor Beame and their advisors therefore decided to elaborate our own plan. Time was running out, however. The city needed $1 billion within three weeks, followed by $1 billion per month for the following six months.

We turned to our only potential sources of funds, i.e., the New York City banks and the pension funds of the municipal unions. To provide greater security for bondholders we created a new state agency, the Municipal Assistance Corporation, which had the backing of the state. We were able to raise $1 billion by selling bonds to the public but we still were left with $8 billion to go and still the markets would not reopen to us without government participation. We struggled, for six months, to raise the money from union pension funds, reductions in the work force (60,000 people), loans from the state and restructuring from the banks. But President Ford and his advisors continued to refuse any assistance, seemingly blind to the risks to the markets of such a bankruptcy and eager to make an example of the so-called profligacy of the city.

By the end of November 1975, we had concluded that we could not meet the conditions of President Ford without a crippled city as a result, and New York City was about to file for bankruptcy when we found new allies: the first Western Economic Summit was taking place near Paris, presided by President Giscard d'Estaing of France and Chancellor Helmut Schmidt of Germany. President Ford attended, with other Western leaders and the Chair of the Federal Reserve Bank, Arthur Burns, was a member of our delegation. The French President and German Chancellor warned Dr. Burns of the heavy risks being taken by the Ford Administration's position on New York City. The foreign exchange and the securities markets reacted very negatively and so did the municipal bond markets, making it more and more difficult for even a small municipality to finance.

Giscard d'Estaing and Schmidt warned Ford of a possible global crisis for the dollar and *"the appearance of a bankruptcy by the United States."* At that point, President Ford and his advisors stepped back from the brink. Upon his return to Washington, Ford agreed to a three-year Federal seasonal loan program which saved our city, but at a heavy price. Deep service cuts, reductions in personnel in the tens of thousands, cancellation of capital programs, as well as the imposition on the city of a state financial control board, the Municipal Assistance Corporation. However, within four years the New York City budget was balanced and the city, with the exception of 9/11, enjoyed thirty years of prosperity. However, it would have been impossible without government participation, which unlocked the participation of the private financial actors (the banks, the insurance companies and the pension funds). In addition, the city elected a new Mayor, Ed Koch, who successfully led the city's restructuring, together with Governor Hugh Carey.

The automotive industry is now in a similar position to New York City in 1975. It has submitted a multi-year operating plan with the management committed to profitability at the end of the period. It would be overseen by a financial control board similar to New York City's. It should produce vehicles consistent with the evolution of fuel and environmental standards. Further savings could be produced through asset sales, downsizing, debt-to-equity swaps and, in the case of Chrysler, savings from synergies in the case of a Chrysler merger, which had been discussed some time ago. The issue in the auto industry is partly about the severe recession as well as about costs that exceed revenues and unexciting product design. Any assistance package has to recognize the need to realign costs with revenues and to deal with realistic assumptions.

There was precedent for these actions: in particular, New York City in 1975 and Chrysler in 1980 both received federal assistance after difficult congressional debate.

In 1979, Chrysler teetered on the edge of bankruptcy and the company struggled to get support for a $1.5 billion loan guarantee which ultimately helped to save the company and 250,000 jobs. The company was able to secure the loan guarantee because labor, management and other stakeholders made significant concessions. The company also benefited from the salesmanship of its new chairman, Lee Iacocca, and the support of Detroit mayor Coleman Young, as well as state and local governments connected to plants and with tighter government oversight. The company also had to provide a financial and operating plan as well as short and long term cash flow projections. The strategy included sacrifices from everybody with an interest in saving the company. Congress approved the loan guarantee program after a strong debate and Chrysler survived.

The auto industry can only be saved if it takes the lead in environmental and fuel efficiency standards which would benefit the whole country; . It cannot wait much longer and a bankruptcy of one of the lead companies would carry the same risks that caused the President of France and the Chancellor of West Germany to issue their warnings thirty years ago. It is an open-ended risk, which would impact all the stakeholders, and ultimately all of our economy. It is worth remembering an old saying: never take a risk you are not prepared to lose.

I have learned several lessons from this kind of situation:

1) Be realistic in your assumptions and leave yourself some margin
2) Act early and do not wait for all the data to be in
3) Be truthful with all the stakeholders

These have served me well and I believe them to be appropriate in this case.