

United States House of Representatives  
Committee on Financial Services

Testimony of Matthew J. Slaughter for Full Committee Hearing,  
“Stabilizing the Financial Condition of the American Automobile Industry”

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2128 Rayburn House Office Building

Committee Chairman Frank, Ranking Member Bachus, and fellow members, thank you very much for inviting me to testify on these important and timely issues regarding the American automobile industry. The Big Three automobile companies have very dedicated and hard-working executives and other workers, and they have many collective strengths and talents.

My name is Matt Slaughter, and I am currently Associate Dean and Professor of International Economics at the Tuck School of Business at Dartmouth, Research Associate at the National Bureau of Economic Research, and Senior Fellow at the Council on Foreign Relations. From 2005 to 2007 I also served as a Member on the Council of Economic Advisers, where my international portfolio included the competitiveness of the American economy and related topics.

I base my testimony to you today on my many years of scholarship and public service on the broad issues of how American companies and the country overall can succeed in an increasingly global economy. And I also base my testimony on two deeply held convictions. One is that although the dynamic and related forces of international trade, investment, and technological change have generated—and have the potential to continue generating—very large gains for the United States overall, these gains do not flow to every single worker, company, and community. The other, given the first, is that one of the paramount policy challenges facing America today is how to both continue realizing the aggregate gains of globalization yet also share these gains more broadly.

Despite these convictions—or rather, as I will explain in my testimony, largely because of them—I do not believe that automobile companies merit any new “bailout” assistance from the federal government.

Any such “bailout” assistance would incur large costs to American workers, companies, taxpayers, and the overall economy. Let me list three such costs.

1. First and, in the long run perhaps most importantly, would be the economy-wide cost of substituting product-market competition with resource allocation set by political rather than economic forces. One of the great U.S. policy successes since World War II has been the bipartisan effort to eliminate laws and regulations that stifle competition and innovation in product markets. With this system, productive U.S. companies expand and force their competitors to adapt. In addition, leading companies from around the world sell in the U.S. market and invest in U.S. factories and offices, ensuring that the U.S. economy is exposed to and strives to meet global best practices. All this dynamism has yielded higher productivity growth, higher average incomes, and greater choices for consumers.

A bailout of certain U.S. automobile companies could set a precedent to be followed for many years by many companies in many other industries. Given the limited pool of savings available in the U.S. economy, these bailouts would displace productive investments from firms elsewhere in the economy and would thereby impede long-run economic growth and rising standards of living. This cost would admittedly be incurred over the longer term. But that does not make it any less important. If anything, this cost would be all the more important because of the long-term challenges facing our country such as the slow-down in educational attainment and the unsustainable growth in entitlement spending.

2. A second important cost of any bailout would be damage to America's engagement with the global economy. One dimension of this "global cost" would fall on foreign direct investment into the United States. In 2006 foreign-headquartered multinationals engaged in making and wholesaling motor vehicles and parts employed 402,800 Americans—at an average annual compensation of \$63,538. Across all industries, insourcing companies in 2006 registered \$2.8 trillion in U.S. sales while employing 5.3 million Americans and paying them \$364 billion in compensation. But as the world has grown smaller, today the United States faces stiffer competition to attract and retain these companies. Indeed, the U.S. share of global FDI inflows has already fallen from 31.5 percent in 1988-1990 to just 16.0 percent 2003-2005. Will the desire of insourcing companies to operate in America be enhanced by federal government subsidies for their domestic competitors? On the contrary: too many such bailouts would cost America in terms of a smaller, less-dynamic presence of insourcing companies.

Another dimension of this global cost would fall on U.S.-headquartered multinationals, key U.S. companies which employ over 22 million Americans and account for a remarkable 78.9% of all private-sector R&D. Their success depends critically on their ability to access foreign customers. They do this via exports from their U.S. parents. But even more important is via local sales of their foreign affiliates created via FDI abroad. In 2005, U.S. parents exported \$456.0 billion to foreign markets. That same year their majority-owned affiliates tallied nearly \$3.7 trillion in total affiliate sales--\$8.10 for every dollar in parent exports.

The policy environment abroad, however, has been growing more protectionist towards the trade and FDI so important to U.S. multinationals. Multilateral efforts to liberalize trade in the Doha Development Round died in July with no prospects for restarting. Even more worrisome are rising FDI barriers. In 2005 and 2006, the United Nations tracked record numbers of new FDI restrictions around the world—even in major recipient countries such as China, Germany, and Japan. Will U.S.-government bailouts of its "national champions" go ignored by policy makers abroad? No. Instead, U.S. bailouts will likely entrench and expand their protectionist practices. This would erode the foreign sales and competitiveness of U.S. multinationals—and would thereby reduce their U.S. employment, R&D, and related activities as well.

3. A third and more direct cost would be the likelihood that any new taxpayer assistance would go largely or entirely unpaid. Public filings by GM, Ford, and Chrysler make clear that in the past two years they have collectively lost scores of billions of dollars. For Ford, operating losses were \$2.8 billion in 2007 and \$8.7 billion in first nine months of 2008. The operating losses for General Motors have been even larger: \$43.3 billion in 2007 and \$21.3 billion in first nine

months of 2008. And this total in Ford and GM's operating losses over 21 months of \$76.1 billion was incurred almost entirely before the sharp downturn in economic activity and heightened capital-market turmoil since mid-September.

All this suggests that today the Big Three firms are losing money at a rate in excess of \$4 billion a month. Because this underlying dynamic has been at play for quite some time, without fundamental structural changes in these companies an infusion of capital from any source—public or private—runs a high risk of not being repaid. As I address below, a relevant question for taxpayers thus becomes how to structure a different deployment of public funds to support the workers and communities affected by a struggling Big Three.

These three important costs of any new bailout assistance do not imply that the federal government should do nothing at all about the very serious challenges facing the Big Three. Indeed, the federal government can help minimize the economy-wide costs of these challenges. Exactly how will depend on what the future holds for these companies. In struggling industries, one common outcome is for firms to merge. Alternatively or in addition, there is reason to expect that bankruptcy awaits some number of American automobile companies. On this issue, it is important to emphasize two points.

1. Bankruptcy and, more generally, plant closures and job restructurings related to both bankruptcy and mergers, are not uncommon occurrences in the overall U.S. economy. Rather, they are essential for overall economic growth because they are a principal channel through which capital, people, and ideas get reallocated to the most profitable business opportunities.

Amidst all this dynamism, every single job separation can be difficult for the worker and family involved. This is important to emphasize, and I shall return to it below. But often-heard numbers regarding job reductions must be put in context to be properly understood. Suppose that a bankruptcy filing by one of the Big Three were to lead to 50,000 layoffs. Last week our U.S. Bureau of Labor Statistics reported that in September, the total number of gross job separations was 4.053 million. At an average of about four 40-hour work weeks per month, this means that on average a remarkable 25,000 jobs are destroyed in the U.S. economy every hour that America is open for business. Indeed, my hypothetical 50,000 layoffs from a bankruptcy filing happens every day in the aggregate U.S. economy in less time than this hearing will take.

2. A bankruptcy filing for an automobile company would very likely mean restructuring, not liquidation, in which case many of the company's operations would continue. Much of today's discussions presume that upon filing bankruptcy all jobs at a company—and all those at any suppliers—disappear immediately and forever, with all affected workers rendered unemployed immediately as well. This presumption is simply not an accurate reflection of most bankruptcy proceedings initiated under Chapter 11 rather than Chapter 7 of U.S. federal bankruptcy code. In most bankruptcy cases, many day-to-day operations continue as the company is restructured on many dimensions to restore long-term business viability. And even under Chapter 7 filings, asset sales as part of liquidation often result in continued operation rather than shut-down by the acquirer.

This is not to say that bankruptcy restructuring is simple or painless. It is not, a point to which I return below. But it is to say that the proper perspective for analysis is not one of immediate and permanent redundancy of the entire company.

So if the future of the American automobile industry may involve some combination of additional downsizing, new mergers, and perhaps even bankruptcy, what role should the federal government play? As stated earlier in my testimony, I regard the proper federal-government focus not to be on impeding market forces but rather on addressing the distributional pressures of these market forces. This focus suggests three areas for federal-government assistance. Let me list these in increasing order of breadth.

1. First, the federal government could help expedite any bankruptcy proceedings. Because of the weak overall U.S. economy minimizing delays in any filing would be of paramount importance. This assistance would help maintain economically sensible activity not just at the Big Three themselves but also at their suppliers as well.

The exact nature of government assistance in bankruptcy would need to be determined. One possible example might be insuring warranties on new and/or existing cars. The concern has been raised that a bankrupt car company would experience a sharp drop in demand because prospective customers would worry about the quantity and quality of warranted after-sales service. Until such concerns were allayed by actual performance in and beyond bankruptcy, the government could insure such provision.

2. Second, the federal government could extend targeted and temporary aid to workers and communities deemed to be adversely affected by a bankruptcy filing or other industrial restructurings.

The Big Three are geographically concentrated in certain Midwest communities and states. Many of these areas already face hardship from the national economic slowdown in general and from falling home prices in particular. Plans could be laid now for extending supplemental benefits, beyond standard unemployment-insurance amounts, to whatever workers in whatever communities are deemed worthy of such support.

The political process would need to determine the appropriate amount and kinds of supports. For now, let me simply state that in light of the size of bailout funds currently being proposed, the potential per-worker supports are extremely large. Today the Big Three employ about 200,000 workers in the United States. If the government reallocated the previous \$25 billion in loans allocated to the Big Three and the under-discussion additional amount of at least \$25 billion more and planned instead to somehow distribute these taxpayer dollars to workers, this would translate into \$250,000 for every single Big Three worker. This could be allocated across several years of unemployment income benefits, of wage-loss insurance upon re-employment, of retraining and relocation expenses: whatever combination of social-safety-net policies we as a country might deem appropriate for these (and perhaps other) workers.

3. Third and perhaps most importantly, the federal government could use this auto-industry crisis as an impetus for meaningfully expanding the economy-wide social contract I mentioned at the outset of my testimony, to better distribute the gains of our dynamic economy.

In recent times, I have researched and written several studies on how public policy could better support American workers and communities while still expanding the global engagement and technological change so critical for raising U.S. living standards.<sup>1</sup> We as a country could do this in many ways: by linking future trade and investment liberalization to a more-progressive tax code; by a fundamental overhaul of our Unemployment Insurance and Trade Adjustment Assistance programs; and by new insurance mechanisms that would allow communities to smooth out their tax revenues. Policies like these would help America grow more equitably in the long run. As the old saw goes, there is no time like the present to start deliberating and implementing such policies.

Let me close by thanking you again for your time and interest in my testimony. I look forward to answering any questions you may have.

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<sup>1</sup> “A New Deal for Globalization,” Kenneth F. Scheve and Matthew J. Slaughter, *Foreign Affairs*, July/August 2007, pp. 34-47. *Succeeding in the Global Economy: A New Policy Agenda for the American Worker*, Grant D. Aldonas, Robert Z. Lawrence, and Matthew J. Slaughter, The Financial Services Forum policy research report, June 2007. *Global FDI Policy: Correcting A Protectionist Drift*, David M. Marchick and Matthew J. Slaughter, Council Special Report, Washington, D.C.: Council on Foreign Relations, June 2008. *An Adjustment Assistance Program for American Workers*, Grant D. Aldonas, Robert Z. Lawrence, and Matthew J. Slaughter, The Financial Services Forum policy research report, July 2008.