

## **CRASH: The Auto Industry Crisis Seen Through the Lens of *The Quiet Coup***

**By Jennifer Glick**

*Abstract:* The purpose of this paper is to determine how Obama's current stance on the auto industry crisis has affected the industry itself, and the likelihood that the current crisis can be quickly and effectively solved. Simon Johnson recently published a relevant article in which he argues that the current economic crisis can be easily solved, but the era of large financial oligarchs has to end. These financial oligarchs, at least in terms of the auto industry, include the United Auto Workers (UAW), the bondholders, and the corporate elite. Obama's current policies, though perhaps a step in the right direction, favor the UAW and thus do not have the all-reaching effect that Johnson says is required to save the economy.

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Statistically speaking, for every one of the millions of Americans directly employed by the auto industry, seven other Americans are indirectly employed by the glass industry, the steel industry, the rail industry, the plastic industry, and many other industries that all rely on the successful and continual creation of cars.<sup>1</sup> This means that any fiscal crisis that impacts the auto industry impacts not only those employed by the auto industry, but seven times as many other workers as well. Because of the number of workers impacted by the financial crisis affecting the auto industry, the steps taken to address the current crisis must be quick, sound, and dramatic. However, according to Simon Johnson, a writer for the Atlantic Online, President Obama is not solving the current auto industry crisis -- he is merely switching its key players.

In his recently published article *The Quiet Coup*, Simon Johnson, explains that to combat any financial crisis, the government must directly attack the "financial oligarchy." Johnson further explains that this oligarchy consists of anyone who is able to manipulate the government to receive what he wants (e.g., subsidies or tax breaks). Although Johnson's solution, which is to have the government battle the oligarchs, is directly aimed at the broader economic crisis, it is applicable to the narrower realm of the auto industry.

Before applying Johnson's potential solution to the auto industry, an overview of the crisis in which the Big Three automakers have found themselves is required. While the current crisis within the auto industry may appear complex, its main causes can be traced to two different market problems. First, concessions made to the United Auto Workers (UAW) have crippled the American car industry. Second, even prior to the US financial crisis, auto companies were facing increased foreign competition due to public perception of foreign cars' superior quality and pricing. Third, as a result of the oil crisis and the rising popularity of the "green" movement, Americans preferred to buy more environmentally friendly automobiles, which were more readily available abroad.

Chrysler, Ford, and General Motors (GM) made significant concessions to the UAW beginning in 1970 when the UAW orchestrated a successful strike against GM. At that time, GM was willing to give the union whatever it desired, and the other major auto firms swiftly followed suit. This led to a negotiation of contracts which favored the union, and a steadily increasing number of benefits for

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<sup>1</sup> Center For Automotive Research. March 2001, <<http://careerrpm.trishield.com/automotive-industry.shtml/>>

union members, including overtime pay for more than five or six hours of work, increased pension and health care benefits, and a retirement provision that allowed any worker, regardless of his age, to retire after only thirty years of work. The list of benefits continued to expand through the early years of the 21<sup>st</sup> century. The combination of locked-in contracts that were not easily changed and the immense amount of spending these contracts necessitated, gave the auto giants very little room to move even before the financial crisis struck the entire market.<sup>2</sup>

Another important reason for the current crisis among the Big Three is the competition from foreign carmakers.<sup>3</sup> Even prior to the US financial crisis, Americans perceived US cars to be inferior to foreign cars. This perception was furthered by the media, which told Americans that American cars were less reliable, and of lower quality.<sup>4</sup> This led to increased demand for foreign cars, which of necessity, led to a decrease in domestic car sales. Although the Big Three tried to improve the quality and performance of their vehicles, the improvements were implemented over too long a time frame and were insufficient to change Americans' car purchasing preferences.

In addition, even before disaster hit Wall Street, the auto industry was having difficulty keeping up with the changes in consumer sentiments as a result of the oil crisis and the rising popularity of the "green" movement. Men and women who had previously purchased SUVs, which the US was very good at making, went "green" and purchased smaller, cheaper, and more fuel-efficient cars. Because the US was not prepared to produce these fuel-efficient vehicles, Americans imported them from abroad. Many other countries, including Japan, have been and remain very good at producing flex-fuel vehicles. When oil prices skyrocketed earlier this year, this trend toward importing fuel-efficient cars intensified, and the Big Three developed vast unsold inventories.<sup>5</sup> Although the Big Three tried, and are still trying, to lower their prices to entice consumers to purchase American vehicles (e.g., through "employee pricing" and cash incentives), these measures have not provided the degree of success GM and Chrysler need to stay afloat. With no one to buy the cars, and no way to cut costs from the airtight contracts with the UAW, GM's and Chrysler's fall from glory seems almost inevitable.

Johnson's proposed solution is contingent upon the existence of a financial oligarchy within the auto industry. Therefore, the next step is to determine which entities are the financial oligarchs in the automobile industry. Three groups stand out as front-runners in this decision: the UAW, the bondholders, and the leaders of each of the Big Three companies. The UAW arguably has the most interesting and multi-faceted claim to being a member of the financial elite. This is because the union has been both crippled and supported by the financial crisis. If on balance, the crisis has hurt the UAW more than helped it, the UAW does not have a claim to be the auto industry's new financial oligarch. If, however, the crisis has aided the UAW more than it has harmed it, the UAW has the potential to become a financial oligarch. The main argument that the auto crisis has significantly hurt the UAW is that the union, though previously very successful, has been forced to agree to significant concessions in order to keep the auto industry out of bankruptcy court. President Obama actually rejected the first set of concessions because they were too lenient, and he demanded that a new set be agreed upon. The UAW complied with this request and cut many items from its contracts that had been negotiated for its workers in years past. This, however, is where the issue gets complicated, and an argument can easily be made that the UAW is the winner in this financial turbulence. Although the UAW lost a good deal of physical wealth, due to the immense amount of money owed to it by the Big Three, the UAW was granted a significant share of each company's stock portfolio. The UAW also has President Obama's implicit backing, because despite his rejection of the first set of concessions, he knows how essential

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<sup>2</sup> Paul Ingrassia. [The UAW in the Driver's Seat](#). 30 April 2009

<sup>3</sup> Boston Globe. [President Rejects GM, Chrysler Rescue Plans; Obama Warns Cash Infusion Could be Last](#). 31 March 2009

<sup>4</sup> Business Week, David Kiley. [Would You Buy a Car From Chrysler?](#) 1 May 2009.

<sup>5</sup> Shamus Cooke. [Obama and the Crisis of the US Auto Industry](#). 1 May 2009

the labor party is to his political standing, and thus to any policies or elections he may decide to commence in the future, and accepted the second set of concessions. This second set of concessions also included a large share of GM and Chrysler's stock, which could prove to be even more influential in future negotiations than actual money. Ford has not accepted such a proposal from the UAW because Ford has managed to continue without government funds, and thus has avoided government oversight. As a result, it has more wiggle room to negotiate with the UAW than its sister companies.<sup>6</sup> The net effect of all of these rearrangements positions the UAW to become the new financial oligarch of the auto industry.

However, the UAW is not the only one involved in this fiscal fray. The old financial elite, the bondholders and company managers, still has power, and is opposing any shift that would give the UAW greater influence. The bondholders are upset because under the new bankruptcy plans for GM and Chrysler, the bondholders will receive only a tiny fraction of their original investments, and a minimal amount of stock in the company.<sup>7</sup> Although the large bondholders, who are mainly huge banks, acquiesced due to the government's control over new funds for the firms to borrow, the smaller bondholders have threatened to take the matter to bankruptcy court in an attempt to receive a bigger piece of the pie.<sup>8</sup> Small bondholders who currently hold portions of GM are even planning to make this threat a reality on June 1<sup>st</sup>. However, due to President Obama's support for labor, and the Big Three's need to cut costs somewhere, the bondholders will most likely still receive the short end of the stick, while the UAW receives the lion's share of the auto industry.<sup>9</sup>

The other group of the old financial elite is comprised of the leaders of the Big Three companies. This group seems to be the clear loser in every proposed scheme. President Obama even followed Johnson's advice when he took on this particular financial oligarch, and he did this by effectively firing Mr. Wagoner, GM's CEO. Although there is a sketchy sort of precedent for this kind of a maneuver (President Carter fired the head of Chrysler thirty years ago), this was the first time that a president directly and openly interfered with the hiring decisions of a firm.<sup>10</sup> President Obama also forced Chrysler to undergo a merger with the Italian carmaker Fiat as a prerequisite to receiving any additional government aid. Chrysler is currently involved in negotiations with the Italian brand, and it is likely that a settlement will be reached quickly due to Fiat's desire to expand, and as Johnson stated, the security within Chrysler that is ensured by the government's backing of the troubled auto giant. No matter how the issue of the old financial elite is viewed it is clear that their time of glory is over due to President Obama's harsh and unprecedented tactics.

Although it may seem that President Obama is ousting the financial oligarchs, his plan will merely replace the old financial elite, the bondholders and company managers, with a new oligarchy – the UAW. Large bondholders, which tend to be banks that rely on federal funds to remain solvent in this financial crisis, must support the government position and accept the loss on its investment. Small bondholders, who are not required to support the government, will almost certainly take their case to bankruptcy court to garner a slightly larger share of the available capital. However, because President Obama's priority is to support labor, small bondholders are unlikely to make meaningful forward progress. The prospects for CEOs are much darker in a world in which President Obama can override any decision that the CEOs make. In this environment, CEOs no longer have any influence. However,

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<sup>6</sup> The Economist, [An Offer You Can't Refuse](#). 7 May 2009

<sup>7</sup> [An Offer You Can't Refuse](#)

<sup>8</sup> The Economist.com. [End of the Road](#). 30 April 2009

<sup>9</sup> Fox News. [General Motors Prepares Bankruptcy Protection Announcement](#). 31 May 2009, <<http://www.foxnews.com/politics/2009/05/31/general-motors-bondholders-accept-sweetened-deal-swap-debt/>>

<sup>10</sup> The New York Times, Jim Rutenberg, Peter Baker and Bill Vlasic. [100 Days: Early Resolve: Obama Stand in Auto Crisis](#). 29 April 2009

the UAW will only lose in a situation where this conflict goes to bankruptcy court, but even in this worst-case scenario, they may still win, because of the Presidential backing. GM's recent bankruptcy proves this point, as the UAW will receive a 17% share in the newly restructured company, and the bondholders will receive only 10%. The government will receive 60% of the company, and this share will almost certainly be used to further the interests of labor. President Obama is replacing the old financial oligarchy – the bondholders and the CEOs – with a new financial oligarchy – the UAW. In other words, he is rearranging the influential players, not eliminating them. Johnson would thus argue that President Obama's bankruptcy plans will inevitably fail.

President Obama, however, has not given up hope. He is currently trying to help America regain its share of the automobile market by pursuing domestic fuel efficiency standards that ensure new American cars meet the niche for fuel-efficient vehicles that has developed within the auto industry.<sup>11</sup> President Obama also recently joined an international fuel standards alliance, which will ensure that future cars made under his leadership will be able to run on an average of 35.5 miles per gallon by 2016.<sup>12</sup> In other words, in addition to rearranging the auto industry's financial oligarchy, President Obama seeks to impact its product line. Simon Johnson's theory speaks only to the restructuring of the financial oligarchy, it does not address other changes mandated by the government. Johnson suggests that in order to combat a financial crisis, the government must attack, not merely restructure the financial oligarchy. Therefore, according to Johnson's theory, President Obama's restructuring plan is doomed to failure. However, his shifts toward a fuel-efficient market will hopefully achieve some measure of success.

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<sup>11</sup> The Gazette, Sheldon Alberts. My Way or the Highway, Obma Says: Takes Ailing Carmakers to Task; Chrysler Must Reach Merger Deal with Fiat Within 30 Days as a Condition for New Aid. 31 March 2009

<sup>12</sup> Financial Times, Tom Braithwaite and Bernard Simon. Obama Unveils Fuel Efficiency Alliance. 19 May 2009

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