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What if GM goes broke?

Neither a bailout nor bankruptcy may save General Motors or the other Detroit automakers. So imagine the cost of losing GM, starting with millions of jobs.

By [Michael Brush](#)

The downfall of Wall Street icons like **Bear Stearns** and **Lehman Bros.** ([LEHMO](#), [news](#), [msgs](#)) may have just been the warm-up.

Soon we may wave goodbye to a true American legend: **General Motors** ([GM](#), [news](#), [msgs](#)).

Yes, it's almost unthinkable that this century-old industrial giant could go the way of the DeLorean. But the maker of Chevys, Buicks and Caddies has been driven to the brink by lousy management, intransigent labor unions, [high gas prices](#) and an economic slump that has kept Americans off showroom floors.

GM cars are selling so poorly that revenue plummeted 45% in October. Its stock has slumped to levels not seen since the days when it introduced power steering. Cash flow has dried up to the point where 2009 could be the year that GM dies.

The government is debating a bailout for GM and its Detroit brethren of about \$25 billion. But cash alone wouldn't save GM, **Ford Motor** ([F](#), [news](#), [msgs](#)) or **Chrysler**, a trio that can only facetiously be called the Big Three anymore.

Politicians would have to find the guts to stand up to the labor unions and the retirees taxing the companies' resources. They'd have to find the courage to boot out the managers who led the automakers into this mess. Without those changes, a bailout would just be a bandage.

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The alternative, using bankruptcy to slough off lenders and reorganize the way airlines have done, might not keep automakers alive either. Unlike an airline ticket, a car is a long-term purchase. Consumers say they wouldn't buy a car from a company in bankruptcy because they worry that warranties and replacement parts might not be there when they needed them.

If I had to bet, I'd bet on a bailout -- either right away in a vote on a loan package that could come in Congress as soon as this week or after Barack Obama takes over as president Jan. 20. But let's hope real change comes with it.

The stakes are huge

Imagine the potential ramifications of losing just GM, the biggest of the Big Three.

Millions of jobs: [General Motors](#) employs 123,000 people, and losing those jobs would be bad enough. But GM's demise could set off a chain reaction that might cost the country almost 3 million jobs. Here's how.

General Motors regularly owes auto-part suppliers such as **Delphi** and **American Axle & Manufacturing** ([AXL](#), [news](#), [msgs](#)) lots of money. If GM declares bankruptcy, a court could relieve GM of its obligation to pay off its debts to those suppliers, which could topple them. The death of GM could have a similar effect in the longer term.

"The ripple effect could be huge," says Van Conway, a bankruptcy expert at Conway MacKenzie & Dunleavy in Birmingham, Mich., who has worked on restructurings and turnarounds in the auto sector.

"If General Motors goes down, their supply base will go down," agrees Brett Smith of the [Center for Automotive Research](#). That might disrupt production at Ford and

Chrysler enough that those two car companies would fail as well.

In this disaster scenario, the upper Midwest could lose nearly 3 million jobs, the Center for Automotive Research calculates. It estimates the Big Three automakers employ about 240,000 workers. The car business supports an additional 974,000 jobs among suppliers and related companies, and 1.7 million jobs are created by all the money all those people spend.

Sure, foreign automakers with U.S. factories, including **Honda Motor** ([HMC](#), [news](#), [msgs](#)) and **Toyota Motor** ([TM](#), [news](#), [msgs](#)), would pick up some of the slack. But many of the cars they sell here, such as the hybrid Prius, are made abroad. So these companies wouldn't do enough hiring to offset all the job losses, and they generally pay workers less.

The hit to the consumer: Yes, we'd all lose the option of buying GM favorites like the Malibu or the Silverado. You'd hear no more romantic songs about pink Cadillacs or red Corvettes.

But more seriously, the loss of domestic auto companies would cut the number of producers, which means less competition. The remaining automakers would raise prices, at least in the short term, predicts David Thomas, a senior editor at Cars.com. "You would be paying a lot more for a Toyota Corolla than you ever thought you would be paying."

The hit to the press: Foreign automakers such as Honda, Toyota and **Volkswagen** ([VLKAF](#), [news](#), [msgs](#)) spend far less on splashy newspaper ads than U.S. car companies do.

"That is one way they keep their costs low," says Thomas, of Cars.com. So a GM failure would be another blow to an ailing industry already hit hard by subscription and revenue declines as readers and advertisers move to the Internet.

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Sen. Evan Bayh, D-Ind., and CNBC's Phil LeBeau discuss proposed aid for Detroit's Big Three.

The cost to government: Lost jobs and lower wages means lost tax revenue.

Federal, state and local governments would lose more than \$156 billion in the three years after a failure of the Big Three in Detroit, the Center for Automotive Research estimates. That's money that other taxpayers -- or their children -- would have to make up.

The demand for government services would likely rise as well, as many of the best-paid blue-collar workers in America started job hunting in a weak economy. Auto-sector pensions would have to be picked up by the government -- a huge cost. And both autoworkers and the automakers' retirees would likely need help with health care just as Obama and congressional Democrats were looking for ways to cover the uninsured.

The political cost: If one or all of the Big Three auto companies failed in the first year of Obama's presidency, it could leave voters disillusioned, wiping out much of the good will he has built up and making it harder for him to lead on other issues. The loss of General Motors would also be a hit to our prestige as a nation. Americans share a passion and pride in their cars.

Practically, losing millions of good jobs will make it the task of turning this economy around that much tougher. Letting GM die is not something any politician would want to answer for.

[Continued: Why GM is failing](#)

The problems run deep

How did GM get into this mess? Politicians need to understand the problem if they are going to help get GM out of it.

Reason No. 1: missing the trends. Consumer ratings and car reviews confirm that

the quality problems which once plagued Detroit are long gone, Morningstar analyst David Whiston says.

Yet many American consumers are now loyal to foreign brands, a sea change from Detroit's good old days. Why is this? Because foreign car producers such as Toyota do a better job of knowing what consumers want and using innovation to get there, says Steve Spear, an expert on the auto sector who is a senior lecturer at Massachusetts Institute of Technology.

While General Motors focused on churning out gas-guzzling SUVs and the Hummer over the past two decades, Toyota was watching subtle shifts in consumer desires and applying technological innovation to develop a fuel-efficient hybrid car. The result: Toyota's Prius is a big hit while GM's Volt is still stuck on the production line, Spear says.

To GM's credit, its fleet includes the largest number of vehicles that get better than 30 miles per gallon. Yet GM made another tactical blunder in this area: It has put fuel-efficient cars low on the list of models getting upgrades over the past few years. The upgrades made its larger cars more competitive, Cars.com's Thomas says, but left GM without desirable fuel-efficient cars when gasoline prices spiked this year. That drove consumers to foreign competitors.

Reason No. 2: costly labor. Give credit to the United Auto Workers for agreeing over the past few years to big job cuts, a transfer of retiree health care to company-funded trusts and other concessions that will bring down wages.

But despite these changes, UAW employees are still an elite group. What other employees get rich perks like 95% of wages when laid off, tough job-security measures and rich retirement benefits without having to put a penny into a 401(k) plan?

JPMorgan Chase analyst Himanshu Patel estimates GM has had to pour \$103 billion into employee pension and retirement health care plans since 1992 -- money that could have been used to fund much-needed restructuring, research and product development.

Unions will have to give up more to make GM competitive with Toyota and other nonunion automakers.

Reason No. 3: poor market timing. For some reason, GM managers failed to raise money during the peak of the credit bubble, as Ford did, or late last year right after it had a groundbreaking labor agreement in hand, or even last spring before auto sales nose-dived, points out Patel. Now it's too late, and GM is in a cash crunch.

Indeed, there has been speculation that GM will have a hard time lasting until Obama takes office without a bailout.

The bankruptcy solution

Notice something about these three problems? You can trace them all back to management and the UAW. But GM chief Richard Wagoner has indicated he doesn't plan to leave, and the unions have rejected the idea of making major concessions to get government aid for GM.

That's why bond market vigilantes such as John Lekas at [Leader Capital Management](#) in Portland, Ore., believe bankruptcy has to be a part of any bailout plan for GM.

"You need a changing of the guard over there," Lekas says. "To give them \$25 billion without bankruptcy is nuts. It's like feeding an alligator bread crumbs. You better not stop because the next to go is your hand."

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In bankruptcy, new management could be brought in -- a typical maneuver in Chapter 11. The tricky part is who would select the new management team. It could be a government oversight panel that gets help from outside consultants and debt holders.

In bankruptcy, GM could offload its pension obligations to the Pension Benefit Guaranty Corp., which would pay employees only a fraction of their expected benefits. And if both management and unions bargained in good faith but hit an impasse, a court could force big changes on the union, including lower wages and a

streamlining of workplace rules, says Stephen Selbst, a bankruptcy expert with the New York-based law firm Herrick, Feinstein.

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But imposed bankruptcy won't likely be an outcome here. Politicians are too beholden to the labor unions that helped deliver Michigan and Ohio to go this route. They also lack the courage to throw out GM managers, because they'd probably take heat for meddling in a private business.

So in the end, GM may wind up doing what Chrysler did in the 1980s: sell off foreign divisions while leaning on the government for financial support.

No, that bailout didn't fix Chrysler forever. Like GM today, it's teetering on the brink of failure, and it's looking for a handout again.

This time, we can only hope the government pushes for a real solution, instead of just handing out cash.

At the time of publication, Michael Brush did not own or control shares of any company mentioned in this column.