Newsweek

Stop The Bail Outs Now

Jeffrey E. Garten

NEWSWEEK

From the magazine issue dated Nov 10, 2008

On both sides of the Atlantic, governments are considering ways to buffer their automobile industries against the economic downturn. The EU has just agreed on a $50 billion package to help its companies meet new environmental standards. With Ford, General Motors and Chrysler on the ropes, Washington has just provided an injection of $25 billion to help Detroit retool for stricter mileage standards. Now the Big Three are already clamoring for $50 billion more. Money being fungible, it's not clear how it eventually will be used in both the European and American cases. There are lots of lives at stake here, so no one should be cavalier about government help. But bailing out the auto companies themselves is precisely the wrong medicine.

First came the bank bailouts. Then came the efforts of central banks to lower interest rates and keep economies from imploding. Now comes the attempt of specific industries to get a piece of government largesse, and politicians are particularly susceptible to giving in at this moment. They have dispensed so many hundreds of billions of dollars to save financial institutions that it has become easy to agree to another several billion here and there. Already the U.S. Treasury has given strong indications that it would take stakes in insurance companies.

But once you start, where do you stop? If autos, why not airlines and trains, both of which will suffer from recession. Why not oil companies, which could claim that since petroleum prices have lost more than half their value these past few months, they will be forced to curtail much-needed investment in infrastructure? Why not biotech, which is now suffering from lack of venture capital on one end and a closed market for public offerings on the other, thereby retarding progress on critical medical breakthroughs?

In the U.S., the auto industry is a particularly awful candidate for a bailout. For generations it has represented the epitome of arrogance toward customers and inattentiveness to major societal changes. For decades, Detroit ignored the challenge from Japan, even as Toyota and Honda made cars that were of much higher quality, more stylish and more economical. Since the 1980s, Detroit automakers have lived off the profits of their captive finance companies rather than the sales of autos themselves, acting more like banks than highly competitive manufacturers. At every adverse turn, U.S. auto chiefs ran to Washington for help—for the bailout of Chrysler in the 1970s, for trade protection against Japanese imports in the 1980s, for help in breaking into the Japanese market when Japanese consumers couldn't figure out why they should buy gas-guzzling cars with steering wheels that were, for them, on the wrong side of the road. Time and again, the U.S. auto companies lobbied against even modest environmental laws, as if they bore no responsibility for the air they pollute.

The demise of the Big Three would not be the end of the U.S. auto industry. Toyota, Honda, Hyundai and others could fill the market. Most already make cars in the U.S., and if Detroit craters, they will move more production there, perhaps taking over some of the Big Three's facilities. Which raises another point. Of course, America would prefer to be a manufacturing superpower with its own brands. But it just may be that the future of auto production is in Asia. After all, it won't be that long before China and India join Japan and South Korea in having a world-class auto industry. Tata & Sons now owns Jaguar, and it has also produced

the first viable auto costing under $3,000. In subsidizing Detroit, Washington may only be delaying its inevitable demise.

It may also help fuel a trade war. In France, President Nicolas Sarkozy has already proposed that the government invest funds to take stakes in a variety of European companies. No matter who wins the election in the U.S., it seems likely that Washington will be deeply involved in supporting alternative fuels and other green industries. Perhaps some of this is inevitable and even necessary, but one consequence could well be massive violations of World Trade Organization rules that prohibit overt subsidies. The new battles won't be limited to the United States and the EU, either. In a world of government-backed companies, China, India, Brazil and others are sure to follow our example. The last thing we need now is a series of trade battles such as the one that Boeing and Airbus have been fighting for at least the last 15 years.

A better idea than rescuing industries is to help the people who work for them. Rather than pour taxpayer money into companies, Washington should invest in the workforce. Let's give the autoworkers extended unemployment benefits, education and training for new jobs. Let's make sure that if they are laid off, they get help maintaining their health care and pensions.

No one knows how long the recession will last or how deep it will be. But I am sure of one thing. We won't come out of it with the financial system looking like it did before the crisis, and many of our industries will be reconfigured, too. It is an understatement to say the government isn't smart enough to draw up the blueprints. It has to let the market work. Bailing out the auto companies might be good short-term politics now, but it would be lousy policy.

Garten is the Juan Trippe Professor of international trade and finance at the Yale School of Management.

URL: http://www.newsweek