# THE BROOKINGS INSTITUTION

## ON THE ROAD AGAIN?

## A LOOK AT THE U.S. AUTO INDUSTRY

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PARTICIPANTS

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**Keynote Address:**

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**Panelists:**

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STEVEN RATTNER

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P R O C E E D I N G S

MR. BAILY: Thank you, everyone, for coming. My name is Martin Baily. I'm a Senior Fellow at the Brookings Institution, and I run the Initiative on Business and Public Policy, and this is an event of the Initiative.

We're very privileged today to welcome Steven Rattner, who's going to talk first, and then we'll be followed by a panel discussion.

Steven Rattner recently wrote an article in *Fortune* magazine, and apparently it is coming out today, and apparently he is on the cover of that magazine, so you're getting it here first.

As you probably know, Steven Rattner served as counselor to the Secretary of the Treasury and led the administration effort to restructure the automobile industry. Prior to joining the Treasury in February 2009, he was a managing principal of Quadrangle Group, a private investment firm with more than six million assets under management.

He has a number of other distinguished aspects to his resume, but I don't think -- I think that's a pretty good recommendation right there, so I'm going to ask him to get up and talk, and then I'll introduce the panel once we sit down. We are also going to get questions from the audience, so please be thinking about those as we go on.

Steve, thank you very much for coming.

MR. RATTNER: Thank you, Martin, and thank you to Brookings for affording me this opportunity to say a few words about how we approach the auto situation, as well as what we have to look forward to.

In the time that I was at Treasury and since then, not surprisingly, I found myself repeatedly responding to a few seminal questions concerning President Obama's actions with regard to the auto crisis, and in that context I intend today to provide some background on our work, address these major questions, and close with a brief look ahead.

Just to review, the auto crisis unfortunately reached a crescendo soon after the presidential election. You'll recall that Congress declined to act and President Bush decided in late December to provide $17.4 billion of TARP funding to GM and Chrysler. President Obama and his transition team understood the stopgap nature of that funding. In that context, incoming Treasury Secretary Geithner and incoming National Economic Counsel Director Larry Summers quickly concluded that given the magnitude of the overall economic crisis, they should create a dedicated team to focus on this critical but discreet problem.

With the attention these days surrounding czars, it is important to emphasize that neither I nor anyone else on Team Auto was ever a czar or even a czarette. We reported -- it's my only funny line -- we reported to -- we reported to Tim and Larry and only through them to the

President just like our counterparts addressing other economic problems. The czar stuff arose largely because the failed legislation that I just referred to would have created a true auto czar. But President Obama's view was to accept responsibility for this problem rather than try to outsource it.

The President created two task forces, a cabinet-level group and an assemblage of sub-cabinet economic thinkers. A working group, which was mostly based at Treasury, represented in essence a third task force. As we were getting underway, the two companies filed mandated viability plans on February 17th. Those plans have been in a state of denial as to the magnitude of their problems, the necessary changes, and the conditions under which the administration might provide further assistance. Both companies needed massive reductions in their costs and liabilities, including their legacy health care obligations, their labor costs, and their manufacturing footprints. The President and his senior advisers were of one mind: No more money except in the context of shared sacrifice and restructurings to become truly viable.

It was frustrating that many commentators were suggesting that the government stay on the sidelines and let the companies fend for themselves. With financial markets still frozen, both would have unquestionably run out of cash quickly, slid into bankruptcy, close their doors, and liquidated. That would have meant the elimination of more than two-thirds of American-owned auto manufacturing capability, cost more than a million jobs in the short run, dramatically deepened and prolonged the nationwide recession, and pushed unemployment rates in several states above 20 percent. So, the stakes were high.

In addition to time with the companies, we met extensively with both industry experts and the various stakeholders. We were startled that each stakeholder meeting invariably included a set of asks from the government. We had foolishly assumed that stakeholders eager to help would come with a set of gives. We realized that convincing stakeholders that the government wasn't going to be everyone's piggybank might well necessitate a bankruptcy element.

While changes like renegotiating a labor agreement could be done without bankruptcy because only a single point of negotiation was involved, other important steps like reducing debt involved innumerable individual actors and would be difficult to implement without the cleansing nature of bankruptcy. But bankruptcy was scary.

Most importantly, we shared the concern of many that consumers might be unwilling to buy such a long-lived product with important warranty protection from a bankrupt company. We sought ways of mitigating this risk, such as by having government guarantee warranties for GM and Chrysler car buyers, and we were fearful about the length of a traditional chapter 11 proceeding. Delphi, the large parts manufacturer, had been stuck in bankruptcy for more than three years.

To address this, we decided to utilize an established but less frequently used part of the bankruptcy code, Section 363, to achieve the restructurings. Under that section, a newly formed company would buy the desirable assets from the bankrupt entity and immediately begin operating as a solvent corporation. But make no mistake. These two risks could easily have met a hemorrhaging of cash beyond the means of TARP and certain failure.

As we studied the companies, we realized that GM, while deeply troubled, was still a global company with improving products, the second largest market share in the U.S., and strong operations in important countries like China. We soon could not imagine this country without an automaker of the scale and scope of General Motors. The task became not <u>whether</u> to save GM but <u>how</u> to save GM.

Chrysler was tougher, having been larded up with debt, hollowed out by years of mismanagement, and operating as just a North American player. Chrysler, for example, did not have a single car that was recommended by *Consumer Reports*. The question for us, and ultimately for the President, was whether any restructuring could save Chrysler.

This most difficult decision was debated at great length by Secretary Geithner, Director Summers, and several members of the sub-cabinet task force that I described earlier. Those who felt that Chrysler should be allowed to liquidate noted that buyers of Chrysler's most attractive vehicles -- Jeeps, mini-vans, and trucks -- were likely to turn to

Ford and GM. Thus, the substitution effect would eventually reduce the net job losses substantially. Equally importantly, these additional sales would translate into additional profits for GM, significantly increasing the value of the company and the government's stake.

The group was torn, and so were Tim, Larry, and I. We intuited that the substitution analysis was more right than wrong and that from a highly theoretical point of view, the correct decision could be to let Chrysler go. But facing a short-term job loss of 300,000 amidst the worst downturn since the Great Depression, a liquidation felt like an unacceptable risk if Chrysler could be viable.

However, to underwrite Chrysler's viability, we believed it needed an alliance with a strong corporate partner. The only apparent possibility was Fiat, which had recently been revived by its new management team. Fiat also had stylish small cars and fuel-efficient engines.

At GM we faced a bigger management challenge than even its reputation had led us to believe. Take, for example, the lack of financial discipline. We saw no indication of the finance staff pushing back on the operating divisions to achieve better results as is customary. Analyses seemed engineered to support pre-ordained conclusions. Symbolically, we never heard the words "shareholder value."

The cultural deficiencies were equally stunning. At GM's Renaissance Center headquarters, the top brass was sequestered on the uppermost floor behind locked and guarded glass doors. Executives housed on that floor had elevator cards that allowed them to descend directly to their private garage without mixing with low-ranking colleagues. In that insular world, Chairman and CEO Rick Wagner's team appeared to believe that virtually all their problems resulted from some combination of the financial crisis, oil prices, the end dollar exchange rates, and the UAW. It seemed obvious that any CEO who had burned through $44 billion of cash in 15 months should not continue. Less clear was whether GM would be better off with Rick's deputy, Fritz Henderson, or with an outsider, as Ford had done in bringing in Alan Mulally.

On one hand, few major companies have effected the cultural change that GM needs without fresh blood. At the same time, we were exceedingly nervous about the likelihood of recruiting a thoroughbred outside player, particularly in the midst of the turmoil. Meanwhile, the government had recently forced CitiGroup to replace the majority of its board. If ever a board needed changing, it was GM's, which had been utterly docile in the face of looming disaster. After much discussion, Secretary Geithner and Director Summers decided to recommend a package that would include replacing Rick with Fritz, changing at least half the board, and making an outside director chairman, which should be a universal practice, by the way.

On March 26th, members of the task forces had two meetings with the President and his most senior advisers for him to make his decisions. The President had absorbed his previous briefings and read on them most carefully, allowing the conversation to move quickly to Chrysler. After reviewing the arguments, the President came down where Tim, Larry, and I were. Chrysler had the potential to be viable within (inaudible) lines, and given that the state of the economy was so fragile, particularly in the industrial Midwest, the right decision was to make TARP funds available.

The President's March 30th speech consisted of a set of extraordinarily tough and muscular steps. The departure of Rick Wagner leaked first. I was stunned by the suggestion that the government was somehow out of bounds for asking the CEO, who had lost $13 billion of taxpayer money in three months and was now asking for more to step aside.

In addition, it was commonplace in the private sector for a large investor to tie a new capital infusion to a management change. Moreover, the previous administration had made similar changes at Fanny Mae, Freddie Mac, and AIG in the context of providing assistance.

The more important news, of course, was the President's willingness to have both companies go through bankruptcy if necessary. Well, that critical decision caused much angst, including among strong supporters of the President in Michigan and elsewhere. It dramatically changed the nature of the discussions that we were having with the stakeholders, particularly the senior lenders to Chrysler. Those secured lenders had been insisting that they were entitled to repayment of their entire $6.9 billion. From the outset, that had struck us as ridiculous. The debt was trading at about 15 cents on the dollar, and according to Chrysler's analysis, the liquidation value of the company was around a billion dollars. Clearly, the secured creditors didn't believe that the government would push back and let the lenders have the company until the President spoke. Immediately, the tone of the lenders and all the stakeholders changed, reinforcing the correctness of the President's decision to take a firm line.

In the ensuing negotiations, the lenders were particularly grieved that the UAW's health care trust, known as the VEBA, which ranked below the secured creditors, was slated to exchange an $8 billion existing claim for $4.6 billion in notes and 55 percent of the equity in the reorganized company. Fairly valued, we believed the VEBA was receiving a bit more than half its prior claim, a higher percentage recovery than we were offering to the more senior secure lenders. These lenders felt that this represented a tilt by the Obama administration in favor of labor and against capital. That was simply not the case. At no time did the White House ever ask us to favor or punish any stakeholder. Indeed, we were encouraged to approach the restructurings from a private sector perspective.

Ironically, the governmental pressures we faced ultimately came not from within the administration but from Congress and from local officials. And while many highlighted the disparate treatment between the senior lenders and the VEBA, they chose to ignore the fact that many other unsecure creditors, notably suppliers and consumers holding warranties, received a hundred cents on the dollar.

The fact was Chrysler needed workers, suppliers, and customers to succeed and therefore needed to give them more. This situation was hardly unique to Chrysler. For example, in the steel industry bankruptcies, stakeholders were regularly afforded disparate treatment for analogous reasons. Moreover, if we had given the VEBA or other stakeholders less, we wouldn't have given the lenders more. The two billion that they ultimately received represented a generous premium over both the trading value and the liquidation value of their holdings.

In short, the outcome of the Chrysler restructuring had almost nothing to do with the heavy hand of government and everything to do with the fact that Treasury was the investor of last resort.

We were also accused of having run roughshod over bankruptcy law and precedent. Not true either. While I'm proud of the creativity of our team, every step proceeded normally through the legal system and followed existing bankruptcy law. In fact, early on we had considered and rejected as unnecessary many suggestions that we seek special bankruptcy law.

Equally importantly, the White House never tried to use the auto restructurings to achieve any other policy goals. While we were at work, new fuel-efficiency standards were negotiated by the administration with all automakers without any involvement on our part, and we were never asked or ordered to impose any new technology mandates on the companies.

With respect to the companies' restructurings, we believe that they needed to assume that U.S. car sales, which had peaked at 17 million in 2005, might well not get much above 10 million for the next several years. In the case of GM, it ultimately produced a plan that accelerated the plant closings, eliminated the Pontiac brand, increased the job and dealer reductions, and added white color job cuts. And like Chrysler, GM reached a new agreement with the UAW that put labor costs on a competitive trajectory. All told, GM's debt-related liabilities were reduced from $120 billion to $55 billion, and $8 billion a year of North American structural costs were eliminated. These painful cuts lowered GM's break-even point from a 16½ million car sales rate to a 10 million car sales rate. Only through amputation could GM be saved.

Both companies also have a brand equity problem. Their cars often sell for several thousand dollars less than comparable models made by the Asian transplants. Time and good products can solve this problem, and an important part of our investment thesis was that GM's cars were better than the market gave it credit for. Perhaps because of its lack of financial discipline, GM was, in important ways, in worse shape than Chrysler.

One simple indicator of that was the amount of capital the U.S. government ended up injecting -- $12 billion into Chrysler and $50 billion into GM, even though GM's revenues were only roughly three times the size of Chrysler's. So, we were faced with a tough decision as to how to contribute that capital. If we made our investment as a loan, GM would continue to be saddled with unmanageably large obligations. The only realistic alternative was to inject most of our capital as equity. All of us, especially Tim Geithner and Larry Summers, hated the idea of the U.S. government owning equity in these companies, let alone a majority interest in GM.

But we ultimately concluded that it is better to get something for something than to get nothing for something. To mitigate the obvious risks, the administration developed a set of principles for the USG shareholder, as we called it, that would add strict limits on government involvement post-restructuring to the existing edict that we not ever meddle in day-to-day management decisions.

Among the ideas that were rejected was putting any government employees or official representatives on these boards. This underscored the need to put in place capable, independent boards of directors and strong chairmen. Once again, there was no political interference. Working with Secretary Geithner and Director Summers, we looked particularly for strong former CEOs of significant companies and also wanted to have at least one leading private equity person on each board. I don't believe that I have seen even one criticism of the resulting choices.

In addition to GM and Chrysler, we knew that we need to address the interconnected web of suppliers, finance companies, and the like. We agonized over this. Thousands of suppliers have been devastated, and more jobs have been lost in the auto sector during this recession than in any other category. But we ultimately concluded that Washington could not solve the problems of every company in every part of this industry. We limited our assistance to guaranteeing payment of GM's and Chrysler's obligations to suppliers willing to pay a fee.

We also knew that saving the two automakers would be insufficient if we did not attend to the problems of their related finance companies. Chrysler Financial and GMAC's issues were more closely related to those of the banking sector, and my sympathy grew for those who had been navigating the banking crisis. We ultimately recapitalized GMAC so that it could support new sales by both Chrysler and GM.

By the end of some of the toughest discussions of the entire project, the need for financial services, regulatory reform was inescapable to me. We were fortunate to be operating under TARP rules, which allowed us to allocate capital flexibly without having to return to Congress for additional legislation. As a result, we encountered relatively little congressional intrusion until the two companies virtually simultaneously announced their dealer reduction plans.

Every congressional district has dealers, many of whom are well connected politically. We patiently worked through each grievance and explained that companies, not the government, made these decisions; but the episode left an indelible impression on me. If we had not had TARP money available and had had to seek congressional approval for each use of capital, I am convinced that one or both of the automakers would have been forced to liquidate.

Fortunately, the restructuring survived and the companies began to operate as private enterprises, just as the President outlined and just as we had hoped. Like any patient that undergoes major surgery, a successful recovery is far from assured. For Chrysler, the biggest challenges are its need to regenerate its product line and to manage a significantly leveraged balance sheet. In the case of GM, the overarching question mark is whether without an infusion of new blood its management team can implement the massive cultural change that is needed.

But by dramatically lowering the break-even point for both companies, we believed we were creating a healthy margin for error. Most importantly, we based our projections on conservative assumptions for car sales. Adjusted for new drivers, about 15 million cars a year need to be sold in the U.S. just to keep the fleet from aging compared to the current sales rate of around 10 million. Consumers can certainly postpone their purchases for a while, but the fleet is not going to age indefinitely, and no one has yet invented a substitute for the automobile.

We anticipated that the recovery of these companies will take time. No one should expect overnight turnarounds. Recognize the extraordinary progress that has been made since February in the face of every pessimistic projection. Be patient. Give these companies the time and the space they need and that we factored into their recapitalizations to remake themselves into successful companies.

In conclusion, I am proud to have been a part of this critical element of President Obama's economic recovery plan. I believe that the President made tough, courageous, and correct decisions at the moment of greatest economic uncertainty in our country. Because of his actions, GM and Chrysler have been given a fresh start and every tool needed to again be profitable industry leaders.

Thank you.

MR. BAILY: Thank you, Steve. I appreciate it.

Steve us willing to take some questions from the audience before we do the panel. I'm going to abuse my power and ask him one question and then get things going. There are microphones on either side, so if you position yourselves next to the microphones, that will make the questions easier.

Can I ask you, Steve, to say a bit more about the future of the industry as you see it. You described a situation where the economy was in deep recession and that you felt it was really not viable to let these companies go down at a time of high and rising unemployment and worsening economic situation. But if we look ahead, how do you see the industry in the future? You must have felt that this restructuring was going to generate a viable industry. I'm thinking with respect to automobile fuel economy standards. I'm wondering if GM and Chrysler will eventually become mostly auto importers as opposed to auto producers. Tell us a little bit about how you would see the U.S. industry as a whole a few years from now given the -- you'd rather move away from the podium to take that question.

MR. RATTNER: I'll sit here if you want. I'm afraid of you.

MR. BAILY: I'm just joking.

MR. RATTNER: Just thought they could see me.

Oh, well, let me try to -- I'll try to answer. You had a lot of parts of the question.

MR. BAILY: I did.

MR. RATTNER: So, if I leave out some parts of it, then we can circle back to it.

So, again, I think -- our instructions were fundamental restructuring, viability, a sound industry, not a band-aid approach, not a stopgap approach, not shoveling more money in. This is a tough industry. I came to this industry, as many of my fans were pointing out, fond of pointing out, with absolutely no experience in the automobile sector. I was a Median Telecoms guy. But I had spent 26 years looking at companies. And there's no doubt this is a tough industry. It is a cyclical industry; it is a global industry; it is a competitive industry; it is a tough business. But it is -- I think most people fundamentally believe that the U.S. needs to be in the manufacturing business broadly and the automobile business more specifically, and had we concluded that wasn't possible we might have done something differently. Happily, we felt we could.

So, our view of this is that basically we -- by accelerating the restructurings for Chrysler and GM, we have taken so much capacity out of the North American market that companies should be able to make money.

One of the fundamental determinants of companies to be able make money is not having too much over-capacity, because when you have a lot of over-capacity, then they cut prices and you get all these zero financing and rebates and things like that, and we really wanted to try to get the supply demand balance into better order.

And, in fact, there was a research report the other day by J.P Morgan that compared the state of the U.S. auto industry to the state of the European auto industry where absolutely nothing has happened and, as some of you know, Opel is caught up in a web of politics and economics and whatnot. But where there's been no real restructuring of the industry, there are too many companies, too much capacity, too much everything. But this particular report basically projected that in 2012 it was entirely imaginable that the U.S. auto industry could be operating at something like a hundred percent of capacity, which would be very good for the profitability of all the automakers, not just our two but Ford and the transplants and so forth.

With respect to a couple of the other pieces of your question I remember, and then I'm happy to go back, on the fuel-efficiency standards, as I said, we did not -- you know, that is sort of the companies' issue. We separated that from the administration's policies. For Chrysler, there was no doubt that the decision to seek an alliance with Fiat was driven considerably by that consideration, because Chrysler, on its own, could not have met those fuel-efficiency standards under any sort of circumstances.

And then a related point I would make is that we did not -- you know, for all of the excitement, and I share it, about next-generation vehicles, electric or otherwise -- and we drove the Volt, we thought about it, we did a lot of work around this area -- we are, for better or for worse, hardheaded financial people, and we did not assume, and I think correctly, in our near-term model -- let's say the next five years -- any material contribution from next-generation vehicles. They are coming, we can talk more about them, but it would not have been prudent to have an investment case that assumed profitability from next-generation vehicles. That's just not immediate.

And then another part of your question that I remember is about are these companies going to simply be redistributors rather than producers. You know, we can have a whole session, and I know Brookings has had many, on the whole issue of globalization and competitiveness, and I certainly had my eyes opened on a lot of this as I got into it, again being relatively new to manufacturing. And I won't repeat all the obvious concerns.

Let me just take the positive side for a second and say that among the many benefits of the UAW agreement was the holding out the possibility, or even the reality, of the domestic automakers being able to compete successfully with imports. Certainly the current exchange rate doesn't hurt that -- but even beyond that. So, for example, GM had been deciding where to put a small car plant and really had been deciding between Korea and here, and as part of its negotiations with the UAW it felt that the -- not the hourly wages per se but all the ancillary costs, benefits, work rules, and so forth had been so improved in its new contract with the UAW that it could profitably make those cars in Michigan, and so 160,000 cars a year that would have been made in Korea will now be made in Michigan.

MR. BAILY: Great.

Do you want to take questions? I guess they're coming from each side by the microphones, so --

MR. ROWLAND: Neil Rowland with *Automotive News*. You said a few things in the *Fortune* article that went beyond your speech. I wonder if you could reaffirm those and perhaps amplify them. Specifically, you called GM “perhaps the weakest finance operation any of us had ever seen in a major company.” True? And why do you think that is?

Second, you said Rick Wagner set a tone of “friendly arrogance that permeated the company.” Could you amplify on that please?

And, last, tell us about your last conversation with Rick Wagner where he talked about Ron Gettelfinger.

MR. RATTNER: You know, I thought Brookings was a serious policy institution, so I, like, took out of my article all of that kind of fun stuff and sort of stuck to, you know, fuel-efficiency standards and substitution effect and things like that.

You know, I don’t -- why don’t you read the article. No, you read the article. Look, GM -- unfortunately, we just did not feel GM was really well managed. And the finance area -- I mentioned the finance area in the article, because it’s the area that I felt most comfortable and my colleagues felt most comfortable opining about, because we’re finance guys. I -- you know, other people can opine on the quality of product development or line management or this or that, but we know something about finance departments, and things like simply getting a reporting package produced so that we can know what the numbers were took forever.

The lack of -- when I -- under the Bush loan agreements we were obligated, actually, to approve every request by GM or Chrysler to spend more than a hundred million dollars out of the ordinary course of business, and from the first day I got there we started getting these PowerPoint decks, you know, asking us to approve this amount or that amount and so on, and the lack of financial discipline around -- that really stunned us.

And take for example Delphi. GM had put -- Delphi, as I mentioned, had been in bankruptcy for three years. GM had -- because Delphi was spun off by GM and is a critical supplier of certain parts like steering assemblies, GM had to keep Delphi going, even when it ran out of money in bankruptcy, and so they kept putting money in. But they never really got anything for it. There was never a fundamental restructuring. There was never an exit for Delphi. It really took our showing up to basically say to everybody -- and this was not me; this was some of my colleagues so I'm not trying to brag -- to say game's over, guys -- a little bit like what we said to a lot of the stakeholders -- the game's over, GM is not going to just be your piggybank, and we've got to reach an agreement. So, I could go on and on, but there were many examples.

The "friendly arrogance" that I referred to is I -- look, I think Rick is a decent, honorable, hardworking, intelligent, well-meaning guy. But I do -- we did find that the culture there was very insular, that, as I said in my remarks today, they basically thought the problems related to everything but management in a way, and there wasn't enough of kind of introspection and saying we're not doing what we should be doing or we're not doing as well as we should be doing, we've got to fix it. And it just needs -- you know, it needs a real housecleaning, and I'm sure you know, as well as I do, that virtually everybody at GM, with one or two exceptions, came up through the ranks. Some have been there 40 years or more. Very little new people -- very few new people coming in. And it just needs a shakeup.

MR. ROWLAND: And your last conversation about Rick Wagner.

MR. RATTNER: Well, why don't we take a question from over there. I think you've had the floor a good few minutes. Why don't we take a first question from over there.

MR. WINGFIELD: Thanks. I'm Brian Wingfield with *Forbes*.

Steve, you said that Chrysler needed workers, suppliers, and customers to succeed and therefore you needed to give them more when you were talking about the restructurings, and I assume the same goes for GM as well. I'm just wondering why the deal had to be structured in the specific way that it was, why the union VEBA was given so much. And I guess when you think about the criticism level that the administration -- about taking over companies, this is one of the examples that's frequently cited, how much was that part of your discussion in the auto task force?

MR. RATTNER: Well, let me try to address in case. First of all, to be clear, just so we're all clear, the VEBA did not take over Chrysler. They do have 55 -- first of all, VEBA is legally independent from the UAW. Point one. Point two, they did not take over Chrysler. They have a seat on the Chrysler board, and there's a very -- not very complex but a fairly complicated shareholder's agreement among Fiat, the independent directors that we sought out, the VEBA director, and the Canadian director as to how the company will be governed. So, the -- you know, with all due respect to the UAW, we did not put the inmates in charge of the asylum at all. What we did was they had an $8 billion claim. We need -- and of all the issues -- and Allen Reuther can speak about this when he comes up here if he wants -- my impression was that of all the issues that would be on the UAW's list, preserving the health care situation was very near the top. This is something that they had already in effect negotiated to a more modest level by creating the VEBA, and so where the liability was capped and contained within a box as opposed to being unlimited, it was $8 billion that was required to make that VEBA even close to being full funded, and then we showed up saying it has to be less. And it's a little bit like what I said about GM. When you have to give somebody something, what do you give them? We didn't want to give them more than 4.6 billion, I think it was, of debt, because the company was very leveraged, and that was as much or more leveraged than was appropriate, and so the only other thing to give them was equity. And so we gave it to them. But, as I said, this was not an effort to turn the company over to UAW. This has not worked for capitalism. This was simply an effort to recognize that this was one of the two or three most important on the UAW's list, that we were asking them to take a haircut of perhaps up to 50 percent, depending on how you value what they got for it, and that was simply how the negotiations unfolded.

MR. BAILY: Let's take a couple more general questions, and then we'll start the panel.

MR. CAMPBELL: Thank you for your service. This statement/question's timed out to about 30 seconds. And thank you for your gentle remarks. I thought what you had to say was pretty gentle and gracious.

I'm Carey Campbell. I'm the state chairman of Virginia's independent Green party, a conservative capitalist Green party. We need more trains and less traffic. We have about 27 independent Green candidates on the ballot for House of Delegates this year in Virginia calling for Virginia-wide high-speed rail -- nationwide high-speed rail.

MR. BAILY: Can we get to the question? Can we get to the question please?

MR. CAMPBELL: Well, the question is future-focused. To create jobs, to cut dependence on foreign oil, to grow the economy, shouldn't rail be an important part of these industries that we're talking about today?

MR. RATTNER: You know, six months ago I wasn't even a car guy. I'm not really a rail guy as we stand here today. So, I think I'm -- you know, I don't want to take time from things I might have more to say about. I mean, trains are great. I ride trains all the time. I'm in favor of them.

MR. CAMPBELL: That'll work.

MR. BAILY: Okay, let's get one more open question and then we'll start the panel.

MR. EHART: Yes, William Ehart from the *Washington Times*. You know, these companies still have significant legacy costs. I think Chrysler is still not going to have a new product significantly for about 18 months.

And the other point is that GM is better and almost comparable to some of the Asian imports, but the point being that you have to come out so you're even better than that. You have to come out with something significantly better, analysts were telling me, in order to break that perception gap and cause you to look at GM. You can't just be good enough; you have to be better. Given all that, as an investor, what do you think are the chances of success for these companies, and how does the U.S. get out?

MR. RATTNER: I'm actually optimistic about these companies for the reasons I tried to articulate, that we did a very, very fundamental -- really a complete fundamental restructuring of these companies. There are still some legacy costs, but we really have put them very much in a box and reduced their magnitude.

I've mentioned that we reduced GM's debt-related liabilities from 120 billion to 55 billion. We, frankly, got some pushback from Ford, which said you're going to turn these people into more effective competitors against us than we're able to do.

So, I think we gave them every tool not only that we could but every tool that they need. As I said before, a 10 million car sale rate, which is where we are now. They break even. As it goes up from there, which I personally think it will, they start to make money.

This is a reasonably high fixed-cost business, so there's a lot of operating leverage, and you can rest assured we took a private equity approach to this problem. We analyzed five years of projections. We sensitized them. We looked at different cases. And we believe that both of these companies are viable, and we believe that they both can earn good returns for their shareholders.

As far as how the U.S. gets out, I think I was clear here, and -- I think -- and certainly Tim Geithner and Larry Summers have been clear -- the U.S. government is a reluctant shareholder. We were not a volunteer to this war; we were a draftee. We hated the idea of government ownership. We would like it to be as short as practicable.

Having said that, we -- the government does own 60 percent of GM, relatively small, 8 percent or so, of Chrysler, and so it will probably take time for the government to get out.

You may have seen Fritz Henderson talking at some regularity about preparing for an IPO and the desirability of having an IPO sooner rather than later. There are many reasons to have an IPO, including the discipline of being a public company again. But one of the things that is motivating him to say that is having heard from the government repeatedly we want to get out as quickly as practicable. It’s not up to me to decide how and when that happens.

My own view would be I would agree with that, but to resist a fire sale because I do believe in the value of this company and of its equity, but -- and we studied at great length other privatizations and they’re all over the place, particularly in Europe. Most of them I think take three to five years to exit an equity stake of this size. There have been some that were done faster in very -- with very successful companies in very buoyant equity markets, and there are some that have dragged on longer, and my every sense is that the administration’s goal is to be on the shorter end of that spectrum.

MR. EHART: Thank you.

MR. BAILY: Thank you very much.

We're going to now introduce the panel. So, could the panel come up and sit down and I will just do the introductions? If there's somebody that could actually move the podium so it doesn't get in the way as much, that would be great. I don't know if there's anybody who can do that.

Our first speaker is going to be Cliff Winston. He's a colleague of mine at the Brookings Institution, where he's been since 1984. He's an applied micro-economist, and he specializes in the analysis of industrial organization, regulation, and transportation. Prior to joining Brookings, he was in the Transportation Systems Division at MIT.

The second speaker will be Alan Reuther. Alan is legislator director with the international union, United Automobile, Aerospace, and Agricultural Implement Workers of America, usually known as the UAW. As legislative director, he's responsible for supervising all aspects of the UAW's legislative program, including development of issues, presentation of testimony, and lobbying members of Congress and grassroots activities.

Our third speaker will be Marty Zimmerman. Marty Zimmerman is a professor at the University of Michigan. He's the Ford Motor Company clinical professor -- how do you become a clinical professor at Ford?

MR. ZIMMERMAN: That's because I tell all the students to take two Aspirin and see me in the morning.

MR. BAILY: He's the Clinical Professor of Business Administration at the Ross School of Business at the University of Michigan. Marty Zimmerman's career has spanned academia, government, and business; and in particular he served as chief economist, as well as group vice president at Ford Motor Company where he was responsible for corporate economics. He was also, roughly speaking, a classmate of mine at MIT, which is one reason I persuaded him to come here to this panel.

And I thank you all for being here. We're going to start with Cliff.

MR. WINSTON: All right, thank you very much. I thought what I'd do in my few minutes is just provide some perspective based on the empirical research on the auto industry, at least that I've been involved with, about really the long run evolution of this industry and thinking about this evolution as a basis for government intervention in the industry in some sort of rational basis for public policy and how to assess it.

The key stylized fact that we really focused on is market share, in particular, the long and extricable slide in market share loss of -- the U.S. automakers are the big three. Certainly GM has been singled out as a big part of the problem, but Chrysler and Ford, too, have lost considerable share from earlier periods, particularly the 1970s when roughly nine out of every light car or truck -- nine of every ten car or light truck sold in the U.S. were by one of the big three. Today, you know, that's almost cut in half. So, obviously there's been a big loss in the output that these automakers have provided. What's been going on? Well, the obvious answer is the competition from foreign automakers, but in particular a series of slips, so to speak, which have been building over time and I think really provide perspective on what's going on with these companies and say something about their future.

The first thing certainly began in the early '70s with just the vehicle offerings. When the energy crisis began and people were attracted to the small but reliable fuel-efficient Japanese cars, U.S. automakers really didn't have an answer. They weren't making those sorts of cars. So, inroads began and market share started to slip.

Then the '80s -- the sort of concern was okay, the U.S. automakers are making these kinds of cars but they have a cost problem, that is, there's a so-called $1500 cost differential that got a lot of attention, and then we did some work, and others trying to sort of figure out what the marginal cost differential was, but the argument was that we couldn't compete and costs had to come down in the industry, but in the meantime that was obviously affecting market share.

Then the latter half of the '80s a big part of the problem then became loss in brand loyalty for the U.S. automakers and the gain in brand loyalty for the Japanese cars. As people started to switch to those cars, they liked them, and they were staying with them, and the U.S. automakers were really finding it difficult to get their market share back. All these things sort of building, building, and seeing the shares slip and problems occurring with the U.S. automakers.

Then the ’90s -- it sort of accumulated with just basic value. U.S. automakers actually were improving, both price and quality of their cars. The problem was their competitors were doing it quicker. And we actually looked at comparisons between the utility or welfare, if you will, that the automakers were providing consumers. Again, a big slip. Both the Europeans and Japanese were just contributing far more to consumers’ welfare, and that was contributing again to the slide in market share.

So, by 2000, you know, we had lots of problems that were leading to a slide. But in terms of profitability, U.S. automakers were helped by too robust expansion, the ’80s and the ’90s. Martin Bailey engineered part -- it was of the ’90s expansion. Low gas prices obviously helping with SUVs and high cost -- price cost margins on those large vehicles. And some import protection, too, tariffs on light trucks. So, that was sort of masking the problem in terms of profitability, but the share was going and the weaknesses in the companies were exposed, and by the -- you know, the 2000s, like 4, 5, and 6, there were huge incentives that were offered by the U.S. automakers, much bigger than the ones the Japanese were making.

Just a quick footnote. The magnitude of those incentives was as big if not bigger than the magnitude effectively of cash for clunkers. But interestingly, consumers wouldn't bite on those then. In retrospect, the U.S. companies should have offered cash for clunkers and they might have had a bigger effect, because they had very little effect. Shares just continued to drop, and by the time the recession hit, they were in real trouble, okay?

Now, a big concern or question that we really had is what was going on in these companies? That's one area of resource I don't think we have any answer to. You know, we can talk anecdotally, and that might help about friendly arrogance and the like, and I'm sure there's truth to that, but, you know, what exactly was going on? There's a problem going for 30 years. You're losing share. You're continually running at the problems. Why couldn't you get anything done? Why couldn't you turn the table, so to speak, and start to show improvements?

While new competitors were coming on the scene, like the Koreans, well, we don't have an answer to that question. We'd like to have an answer to that question, but, you know, the policy discussion that arose is okay, what are we going to do?

Now, it's easy to couch this, in terms of an ideological debate whether you want government intervention or not, but there actually is a very rational way to think about this in terms of cost benefit analysis. Government intervention as aid or assistance to the automakers is justified if the amount of taxpayer subsidies is less than the value of the output that would have been lost if those subsidies were not provided, okay? So, the subsidy's got to be less than the value of the output that would be lost.

And what I mean by the value of output, it's the benefit to the offerings of consumers -- in other words, the cars that wouldn't be produced that consumers value, okay, and potentially lost jobs that we don't have because we're not producing that output.

All right, so, that involves what we call a counterfactual, and you don't know what the world would be like. Certainly you could argue forcefully. Steve Rattner's team did: Look, if we don't provide this assistance, you know, we're going to have a very calamitous effect on output; the output is gone; and this will accelerate the recession. Others obviously could argue more forcefully: No, this has been an inexorable trend, you know, we can -- let's go for a sell-off and, you know, we won't have the kinds of concerns that you're saying.

You know, we don't know this. It's very difficult to quantify this. In retrospect, maybe we'll have some answers on this, but here we are now with the current policy, and what I would just suggest in conclusion is I think the team should think of things in a longer-run context. That is, obviously they were caught up in the moment, and that's important, and you have make very tough decisions, but I think this whole debate needs to keep in mind that the problems of these companies have been going on since the ’70s. They didn’t begin last year. And there’s been this slow inexorable loss in market shares. There was simply no effective response.

If you should have looked at the trend line, you know, what I see is sort of a discontinuity during the recession. The government’s come in, but do I expect to really believe that Chrysler and GM in their current incarnations are really going to change things? I don’t. I think that things will continue to slide for them. I don’t see they have an answer. I see, if anything, things are going to be even harder for them, because now with the Koreans coming on I think the other companies (inaudible) it’s going to be tough. Ford obviously is a beneficiary. But I don’t even see Ford’s in great shape either in the long run, and I think that -- from a policy perspective, I think a good thing for the administration to do is to allow this long-run trend at least to evolve and realize that if you asked in 1970, you know, our companies could lose half of their output. is that something that the U.S. should tolerate or should we give big subsidies, a lot of people would say yes, we should have these subsidies, we really can’t afford to have this country lose half its automaking -- half its market share. Now you ask that question, you look back and say wait a minute, that was probably a good thing, right? I mean, if you look at the quality and value of those cars that were picked up, so to speak, and produced by these other automakers, consumers benefited. Now, labor is a more complicated story, but nonetheless even labor did get jobs. They didn't lose everything.

All right, I asked the same thing today. You know, 30 years from now probably the share could be down to 5 or 10 percent of whoever is left. I don't see that's a bad thing.

MR. BAILY: So, you would have not done the (inaudible) in short.

MR. WINSTON: In short, I was advocating in our *Wall Street Journal* article for a sell-off, and in a nutshell --

MR. BAILY: Sell-off --

MR. WINSTON: Sell-off where you could sell and with a vision, as I said, to the long term that decline is inexorable. I mean, GM as we know it is just never going to exist again, and I think we should sort of accelerate the reallocation of resources, which has been going on anyway.

MR. BAILY: Thank you.

Alan.

MR. REUTHER: I'd like to thank Brookings for inviting me to participate, and I'd like to commend Mr. Rattner for his excellent presentation.

On the threshold question should the government have intervened to facilitate the restructuring, UAW obviously believes they were right in doing that. In addition to the massive job loss that would have flowed from the liquidation of Chrysler and GM, I also want to add that if GM had gone down, they would have dragged Ford down, too. We would have seen the total liquidation of all three companies because of the very extensive integration in supply parts to all of the companies. It also would have had a negative impact on production of the Asian transplants, too, so the impact would have been far broader.

The other thing, though, and with all due respect, just look at -- the output of production totally misses the impact on retirees. There's one million retirees that were at stake here. If you'd seen the liquidation of those three companies, those million retirees and their surviving spouses would have lost a significant portion of their pensions. There would have been a huge hit on the pension Benefit Guarantee Corporation, which would have jeopardized the solvency of that agency, which would in turn have jeopardized the retirement income for millions of other workers and retirees. Those one million retirees would have completely lost their health care benefits. A third of them are pre-65s and they would have had no health care. So, it would have been this massive impact far beyond just looking at the output of cars, and I think that's an equation that's totally missed those who say oh, you should have just let them go; somebody else would have picked up the productive assets. Nobody else would have come in and picked up those obligations to the retirees.

In terms of looking at the restructuring and whether it was fair to workers and retirees or to other groups, I would just underscore that tens of thousands of workers lost their jobs and paid the ultimate price. The remaining active workers took about a $7 an hour cut in their compensation. Retirees took an immediate reduction, significant reduction in their benefits, and then going forward, they're going to be exposed to a huge risk by virtue of the claims that were due them being paid in the company stock.

I would also just underscore that these concessions in 2009 were on top of the deep concessions that the workers and retirees had already made in 2007 and before that in 2005, and so as our President has said publicly before, we felt that we were already on third base and the rest of the stakeholders, the bondholders, and others hadn't even gotten to first base yet in terms of stepping forward to have some equality of sacrifice.

I would also just flag that one of the ironies here, one of the main critics of the restructuring now is Senator Corker. If you look at the terms that he tried to impose in December when it was being debated by the Senate and if you hold them up side by side with the terms that were ultimately imposed under the Obama administration, the Corker terms were far more lenient in terms of how the retirees were treated in the VEBAs in particular. So, you know, to say that the Obama administration somehow did a sweetheart deal is just totally contradicted if you compare the terms that Senator Corker was pushing originally.

Finally, in terms of the bondholders and the equity, you know, I would just underscore that many, many bondholders purchase their bonds at sharply discounted rates. Many of the bondholders are large institutional investors who have the ability to spread losses over a broad portfolio. Obviously workers and retirees don't have the ability to do that.

I would also flag the so-called Main Street Bondholders group that got a lot of attention in the media and was created by the 60 Plus Association, which was founded in part by Richard Viguerie, so this was not a genuine grassroots bondholders group; this was a group with a political agenda.

In terms of the future of the industry, there's been a lot written about oh, does UAW now own the auto companies? Are we going to be directing the investments? As Mr. Rattner indicated, the stock is not owned by the UAW; it's owned by the VEBA. The majority of the trustees of the VEBA who govern it were appointed by a federal judge as part of the bankruptcy restructurings and they're independent of the UAW, so we do not control the VEBA. Also under the terms of the restructuring, the investment decisions on stock will be made by an independent fiduciary that will be selected by the trustees. We have no interest in the VEBA continuing to own stock. Our interest is in that stock ultimately being sold to get revenue to help pay the health care benefits.

In terms of what's different about this restructuring compared to past downsizings of the companies, I think as Mr. Rattner indicated, the big difference is that the balance sheets of Chrysler and GM have been dramatically changed in terms of the debts owed to bondholders, debts owed to the retirees. Also the compensation of the active workers has now been put on a level with competition from the foreign transplant companies.

I think the key to the success of the companies going forward is going to depend on overall auto sales. Obviously the cash for clunkers program provided a very short-term benefit, but going forward it's really going to depend on how fast the overall economy rebounds and how fast the auto sales in general rebound. We believe that one thing that can help in that is the government providing additional stimulus to the economy to ensure that the general recovery continues.

I would flag that one of the -- you know, I know a lot of critics of the UAW have said oh, you know, it's great somehow that our compensation was reduced, but I want to flag that there's going to be a ripple effect from that, and one of the effects is going to be that the foreign transplants in this country are now going to look at the $15 an hour that's paid to new hires at the big three and they're going to say well, they have to compete with that, and you're going to see a lowering of the wages and other compensation for the workers at Nissan plants, Toyota plants, Honda plants in the United States. There's going to be a race to the bottom, and I think that's bad for those workers, for the communities where they live.

Finally, the big question going forward is are we going to see an auto industry continuing in the U.S. or are we going to see these companies continuing to shift investment overseas, to move their footprint to Mexico, China, India, etc. That was one of the big issues in the restructuring. The original GM plan called for a shifting of more of their U.S. sales being sourced from plants in other countries. We're pleased that we're able to reverse that. We're pleased that we're able to get a commitment from both Chrysler and GM to produce small cars in this country.

We very much believe the government has a role to play going forward. The 2007 energy legislation provided the Section 136 Advanced Technology Vehicles Program, which was incentives for domestic production of the advanced vehicles. We are very hopeful that a similar program will be included in the climate change legislation, and we think that's absolutely essential to ensure that the next generation of vehicles and the key components are going to be produced in this country and that we just don't wind up with a situation where more and more of the industry gets outsourced to other countries.

At the end of the day, if you ask the question does it make a difference if GM, Chrysler, or Ford survive? It only makes a difference if they're employing people in this country, producing the cars and the parts in this country. If they're just going to be multinational companies, they're only producing in other countries, then I don't think the government and the public has a stake in that, so we think it's absolutely essential to focus on making sure that there continues to be domestic production of these vehicles and the key components.

MR. BAILY: Let me just throw one question -- because Cliff mentioned, and I think it's implicit in what Steve Rattner said, that there was a pretty long decline of market share of the big three. I think -- I don't want to implicate Ford -- Marty Zimmerman can talk about that -- but in work that I was involved in looking at productivity of the industry, GM and Chrysler were very slow to adopt lean production and to raise productivity up the levels of the Japanese transplants. Now, that -- some of that was clearly management, management resistance, management inertia, all of that. But with the benefit of hindsight, do you think the UAW could have done more to arrest that long, slow decline that Cliff described? Would you have done things differently if you had a chance to do it over again?

MR. REUTHER: I think there's a lot of factors that went into the long slide. I would note that J.D Powers indicates that I think it's either nine of the ten most productive plants in North American now are all unionized facilities, so I don't think that's where the problem is. I think historically there was a huge problem with legacy costs that the foreign transplant companies did not have. I think our trade policies also contributed to giving the foreign competitors an unfair advantage so it wasn't a level playing field. I think there was also a problem dating from the '70s with the public's perception of poor quality, and that's a problem that unfortunately has lingered. So, hopefully now that -- you know, that's changing with the new products.

MR. BAILY: Thank you.

Marty.

MR. ZIMMERMAN: Okay, thank you. And thank you for inviting me.

Cliff suggested that it would be nice to know whether or not the value of lost output was equal to the amount of money that the government has put in. I think in the circumstances we were in, in the end of 2008/2009, it would have been nice to have that study, but nobody had that study. We were really making decisions, and the administration was making decisions, based on assessment of risks. And they had a tough choice I think.

The choice was do we provide financing, and I don't think there was any private financing available. The notion of private debtor and possession financing I think just wasn't there. So, the question was do we provide financing or do we let these firms liquidate? Because I agree with Mr. Rattner that it would have been a liquidation, not a reorganization at that time.

And I think the administration made the right decision, that there was systemic risk involved in letting these companies go, and I'll remind you -- I was with Ford, okay? So, I'm talking about I think it was good public policy for the government to come in, as they did, because the systemic risk was not just the failure of the two companies, but it really would ripple through the industrial sector in the United States.

First, clearly, as Alan Reuther mentioned, there was the issue of other manufacturers. They would have suffered because of the collapse of supplier companies, and that would have rippled through, and I think -- in the circumstances we were in at the end of 2008 and the beginning of 2009 -- I think the right choice was to go in and to provide money to prevent that. Now, maybe we'll get a good stay later on that say it wasn't great, but at the time and to this day I think in the circumstances it was a good decision.

If the economy had not been as weak, if the job losses were not as widespread throughout the economy, one could have come to a different conclusion, but I think we have to put it into that context. However, having said that, there are some unfortunate consequences of having the government involved with these companies.

First, we had a discussion a little bit here earlier about whether or not the secured creditors were treated fairly or consistent with bankruptcy procedures, whether the unsecured creditors in the GM case were all treated equally. To me, I think Mr. Rattner gave a good explanation of why they did what they did and in a sense put fairness aside. It sounded like the deal couldn't be done unless they did what they did. Nevertheless, I think the perception of government involvement in the bankruptcy process is something we're going to have to live with for some time. Just the perception -- put yourself in the position of the lender, now, looking at lending either on a secured basis or an unsecured basis to a company. You're going to think about what are the political consequences that could happen? Will my claim be respected? Are there other -- some politically more influential groups involved in this industry, or is this industry itself politically sensitive? And I think that does -- it's unavoidable, I think, given what I said, which is I think the government had to do what it did. But I think there is that perception.

Secondly, I accept the administration's intentions exactly as they said. They don't want to be in the business of owning and managing a company. But I think the pressures that come from government involvement in a company are there, and it's not that the administration will necessarily want to make the decisions, but Congress is a pretty larger board of directors, and it's very hard -- Congress represents the interests of their constituents, and its very hard for a member of Congress not to respond to the dealers who claim they shouldn't be shut down or to environmentalists who claim that they're not producing the right vehicles. So, there is a whole series of should they produce in the United States or not -- a whole series of decisions that will be made that are potentially subject to political pressure. So, I think that the best idea is to get out as fast as they can. Mr. Rattner said that is the intention. I think the tension is going to be -- and I'll talk a little about this in a minute -- the tension is going to be how long do we wait to sell out or to get out, because you'll want to sell, as Mr. Rattner said, at the fire sale prices. On the other hand, as you wait, the pressures build and it's by no means a foregone conclusion that these companies are going to be successful. So, it's not at all clear that by waiting you're going to be able to sell out at a better time.

So, my advice on that would be get out -- the government should get out as soon as possible, and as that tension arises, that is, between holding on, hoping to get a better take versus getting out, I would lean on getting out sooner.

I don't think the taxpayers are, in any case, going to get their full return on the money directly from the money put into the companies. It's possible. I think the industry is going to be a lot better in the next few years. I'll tell you why in a second. But it's by no means certain that they're going to be able to achieve the level of profitability necessary to return all the money that's been put into the companies. However, part of the return has been a social return in avoiding what I thought and still think would have been catastrophic consequences back in the beginning of -- at the end of last year and the beginning of this year.

Let me just say a few words about what the industry looks like going forward. The success of the company's clearly going to depend on the external factors, how the industry does, and it's going to depend on how the individual companies do.

On the external side, people have talked about how there is pent-up demand being built up in the industry because we're selling far below what's necessary just to replace the vehicle stock.

I thought I would give you an indication of how really extraordinarily bad the industry has been. A number that I look at -- I haven't looked at for a number of years -- is the percentage of gross domestic product that is spent on new cars and trucks. And the reason I look at it is it was a very useful planning tool, because it was very stable. At about 4.3 percent of GDP, declining modestly over the decades -- every decade we'd lose a tenth of a percent of GDP. Now, there was cyclical variation around that average, and the cyclical variation -- in good years it would go way above that; in bad years it would go way below that. I went back and I look at where we were in the recession of 1980 to '82. I put those two recessions together, and that ratio declined to 3.5 percent, 3.6 percent to be precise if you use the recent data. If you look at where we are today and where we were in the latter part of last year, we're barely above 2 percent. So, I just did a mental calculation. I said what if we just went back to the recession level of 1980 -- that was not a good year for the auto industry -- at today's transaction prices and today's level of GDP. We'd be selling over 16 million -- 16 to 17 million units.

Now, clearly, that -- what it says to me is that there's a lot of pent-up demand and we're creating that. Now, the question is when does that pent-up demand come to the market. When do consumers feel confident enough to go out and buy a car. You know, we talk about the unemployment rising, and clearly I believe it will rise yet again. But even when it goes to 10 percent, 90 percent of people have jobs. But that 90 percent of the people are not very confident about holding onto that job. You need stabilization in that unemployment rate. Consumers have to feel better. But they will eventually. And so I look for the industry to improve next year and the year after by 2011 based on just the simple calculation I just gave you. It's not a -- I don't think it's really outrageous to expect a 15 million industry that Mr. Rattner talked about -- in fact, by my calculation, which I'm nervous to stretch too far -- you really would get higher than that, okay? So, at that level of industry, given the cost-cutting and the restructuring that has gone on, I think there's some money to be made in this industry.

The capacity reduction will do two things. One, by reducing capacity, the companies have their cost base reduced; and, secondly, it reduces the incentive to offer incentives -- pardon that usage. It reduces the incentive to give away cars as they doing over the last several years just to keep those plants running. So, you should anticipate -- I would anticipate some margin improvement going forward.

Now, that's not to say the future is going to be easy. We have the Chinese increasing their production, increasing their capacity. The Koreans are doing very well. The Indians are getting into the business. So, going forward, I expect higher levels of sales but clearly competition, which will force the companies hopefully to stay on their toes and continue with this emphasis on getting costs down, improving productivity.

I think for the internal issue of the firms, the real question -- and it was stated earlier -- is going to be product. Can they bring product out soon enough that it's good enough to sell without major discounting, with major incentives? And I think the jury is still out on that. Because of the bankruptcies and because of the turmoil that they went through, they had to pare back a lot on product spending. Now they're ramping it up, but there's a gap, and it's going to take a while, I think, for that product. But that will ultimately determine the outcome.

Just, finally, a couple of words on some broad -- I think it's a cliché today to talk about globalization, that the industry is globalizing. But there is an interesting aspect to this. Because of higher energy prices, the United States market is no longer as different than it was from the European market.

It used to be that we produced large cars and SUVs and trucks, because our prices -- our energy prices were very low. People wanted those vehicles, and we had a completely different product mix in Europe.

Today that is changing, because the higher energy prices are forcing the companies to respond to consumer demands for smaller vehicles, more fuel-efficient vehicles. That says that companies really do have to be global to survive, because we need to spread the high product development costs over volumes that are bigger than a single market, and this will allow -- this merging of the markets will allow them to do it, and that's part of the logic behind the fiat deal with Chrysler and it's part of why Ford is bringing in some of its European products, reengineering them for the U.S. safety standards. But basically Ford is going to be selling similar products in Europe and the United States, and I think that that makes sense.

The second trend that clearly argues for larger companies is technology is becoming increasingly important because of the pressure of fuel economy regulations. And I think we don't know what technology is going to merge, but I think companies are going to have to be on the playing field for a lot of technologies, and that costs money, and, again, you need scale.

So, I bring myself back to government policy. Traditionally, the government was involved in three ways. They were a regulator -- fuel economy, safety regulation. They were a technology promoter in the sense of R&D support for advanced technology. And now they've now they've become an owner guarantor of the companies. For reasons I said before, we ought to get out of that last activity.

But the government does have a role, I think, on -- the two I mentioned -- on the regulatory and on the technology front, particularly since I think the regulatory front has pushed so far and so aggressively with the new fuel economy standards that it's going to take a lot of R&D and a lot of R&D support to actually make them.

Thanks.

MR. BAILY: Thank you.

Can I just ask the panel if they want to comment on what the other panelists said?

And let me throw it back to you, Steve. Was there anything that you (inaudible) reacted to that you would want to comment on?

MR. RATTNER: Let me try to very quickly tick four or five things that I heard that I just either want to agree or disagree with.

First, with respect to the idea of what alternatives were in March between a government rescue and whatever else could have happened, in my opinion there were only two alternatives. One was a government rescue; the other was liquidation. I think the idea, with all due respect, Cliff, of sell-offs or reorganizations were just not going to happen. So, we have to really understand what the real -- I think what the real alternatives were at that point.

I think Alan Reuther made a couple of important points about (a) the impact on Ford if we had not helped -- and I didn't have time to cover all this; (b) on health care costs we did calculate that if we had let Chrysler go there would have been several billion dollars of incremental health care costs to be borne by the federal government and the states just simply because of these workers losing their health care coverage through Medicaid, Medicare, and so forth, the PBGC problem that he mentioned.

He also mentioned -- I'm just trying to underscore that when the Bush loan agreements were put in place, for those of you who didn't know what he was exactly referring to, Senator Corker put six provisions in there designed to be tough and to force restructuring, and we ended up being tougher than all of them and in many cases by material margin, so I think it was a very fundamental restructuring.

With respect to the productivity of the industry, which has definitely been a huge problem, we spent a fair amount of time studying this, and others here may know more than I do or have a different point of view, but we became convinced that U.S. productivity really had reached -- for the Detroit 3 had reached the same levels as the transplants. Wages -- labor costs were not the same, but productivity was the same.

MR. REUTHER: Right.

MR. RATTNER: With respect to government involvement in the bankruptcy process, I actually want to tell a little quick funny anecdote, which is that one of the Chrysler lenders, (inaudible), said to me at the end of this well, I'm going to do this, but damn it, it's the last time I'm going to have anything to do with any company that the federal government has anything to do with. And then two months later he called me and he said, you know, there's a lot of business at GM as they come out of bankruptcy. How do you think we should be thinking about that? So, I think a lot of --

MR. BAILY: It's always a question of price.

MR. RATTNER: Yes, it's (inaudible) emotion passes quickly.

With respect to the issue of government selling and how we get out, I certainly would agree it's complicated, it's fraught with peril. I'm cautiously optimistic that smart people will find their way through it. There is precedent not just in Europe, but the government here of course on Conrail at one point, and they'd managed to exit that in I think a prudent way, so it's a risk but one I hope is manageable.

Now, lastly, I just want to comment on the issue of government recovery of the money we put in -- about 75 billion in total -- into the total, about 62 billion into the two companies. The way we think about it, to be very straight with everybody, is really two phases: the pre-restructuring money and the post-restructuring money. I implied in my remarks that the pre-restructuring money, which was done outside of any fundamental restructuring but really was sort of buy-a-little-time kind of money -- I don't think we're going to see again. I think we benchmark ourselves by the money that we put in as part of the fundamental restructuring. In the case of GM, that's $30 billion. If you look today at the value of part of our GM investment that's in debt, which there is a piece -- about 8 billion -- plus the value of the equity, which is trading through the old GM bonds. I won't take the time to explain what all that means. The 30 billion today in the market is worth about 25 billion. So, we're actually, even now, pretty close to being able to imagine getting the money that went in as part of the restructuring (inaudible). and so I'm hopeful that in the fullness time people will judge us all to have been the right set of policy decisions.

MR. BAILY: Cliff, let me ask you. The economy was losing 600,000 jobs a month, so would you have made the decision to just liquidate these companies?

MR. WINSTON: I'm trying to be a scholar here, not engage in the counter-factuals of this sort of thing you want.

MR. BAILY: It's an honest question.

MR. WINSTON: All right. One number that hasn't been mentioned at all -- the cost of this plan. Steve didn't actually mention that in his talk, which is sort of surprising. You got to think about how much money are we actually spending in this program? These come at very, very high costs -- billions of dollars -- and a lot of it is going to involve a transfer. In other words, the point that was made earlier about the pensions -- yes, if we don't spend this money and people lose their pensions, that's a loss on that side of the ledger. On the other hand, if they don't lose it and the taxpayers pay, that's a loss to the public. And too often in all these debates, you know, that part is not considered.

Now, one of the biggest problems in doing all this is the politics of the firms -- and I'll get to your question in a second -- but throughout this whole 30-year-plus slide, I neglected one important point. It could have been far worse. There's no question that Toyota, Honda, maybe others somewhat did not pull the trigger. They had to be careful about how much they could have taken. I think they could have taken a lot more market share, but they're obviously concerned initially about being frozen out of the market with quotas, and then as they were coming here they certainly had to worry about that.

So, when I talk about concern -- you know, interests in a possible sell-off, it's difficult because I don't -- you know, firms had to be very careful during this time, and note of course Ford obviously had to be very careful, too, in its politics about how GM and Chrysler was going to be handled. So, I really just simply don't know enough about, really, what other firms could have done to pick up the slack.

I think in answer to your question, presumably if I were in a position to do that, I'd have to understand that much better. But I was very concerned, as I hope others were, about the enormous cost of this intervention. The long-run slide of these companies -- what could possible be salvaged in the long run from this, and the fact that others in a sense that may have been able to contribute were frozen out.

MR. BAILY: Alan, I want to give you the chance to comment on the other panelists, but I want to press you a little bit on the productivity issue. It's true, I think Steve is right, that by the present time productivity has caught up in terms of output per vehicle. There are some tricky questions there as to how much of the value-added us done in the assembly and how much is done outside. But let's concede right now the best big Three Plants are comparable to those of the transplant.

But I was asking a question about historically. I mean, why did it take GM 15 or 20 years to get the productivity up to the level? I mean, they had a joint venture with Toyota. They knew what it took to make vehicles productively. So, why did it take so long. Was that partly because of the union, or was that just a management failure or are you disagreeing with the facts?

MR. REUTHER: I would disagree with your assumption that, you know, it's only in the last year that the productivity has caught up. I think the productivity's been there quite a while. For some period of time, the union has negotiated changes in work rules and other things to change the productivity, and now in fact it exceeds the productivity at the foreign transplant, so, you know, I don't think that has been the major cause of the long slide downward. In my previous remarks, I indicated I think, you know, the legacy costs, especially in health care, and the fact that unlike the other countries, we don't have a national health care system that establishes a level playing field, a whole imbalance of trade policies, including currency manipulation that's given a huge advantage to foreign competitors. I think there's been a whole series in fact. I'm not trying to say the companies had nothing to blame, that there was a serious quality problem dating from the '70s, and that's unfortunately continued in the public's perception, but I think that's changing if you look at the new products.

MR. ZIMMERMAN: You know, I would just add that I think the companies were making progress. They were making progress fast enough, given the Tsunami that hit with the financial collapse, but productivity was improving; quality was improving. Just go two generations back in the Taurus, the -- I remember that the --

MR. BAILY: Taurus is the shining example.

MR. ZIMMERMAN: Yeah, but I really -- (inaudible) those plants were at Japanese transplant levels, you know, 20 years ago. So, I think there was progress being made. Yeah, I think it's a fair criticism that the progress wasn't fast enough, and this gets to -- you talk about a clinical professor. My first round as a professor I was a straight professor, like Cliff here, and so I looked at the world a little differently, and, you know, I used to teach my students about how they should maximize profits and of course firms are maximizing profits and all that. The truth is progress was being made, not fast enough, but the crisis is what concentrates your mind, and you really are able to do certain things in that environment and in those circumstances and accelerate it, and that's -- it's unfortunate, but that's true.

MR. BAILY: Let me ask you, and maybe throw it back to the panel a little bit, one of the differences in approaches -- production of the Japanese companies and the big three companies is that the Japanese companies didn't necessarily just squeeze and squeeze and squeeze their suppliers. They actually sent engineers into the plants. The demanded all the data, but they said okay, we're going to show you how to cut costs; we're going to show you how to cut costs. Whereas the approach in the U.S. was much more cut costs, cut costs, just do it, and the results have been that a lot of suppliers have gone broke, and so do you have a base of supplies in the U.S. industry that can revive, because after all a lot of the innovations comes out of the supplies not so much out of the OEMs.

MR. ZIMMERMAN: No, it's true that -- first of all, I've gone through various waves of supplier relationships, and it's not true that we've always been beat 'em up, get the costs down. But we have gone through waves, and I would say it's fair to say that we have been tougher in the way you say than the Japanese have been.

I think the pressure that the companies were facing, the domestics, was that they had these high costs. They had the legacy costs. The prices were falling in real terms. If you look at pricing of cars relative to inflation, they've been falling for a long period of time, so given prices falling, more competition, because more and more manufacturers who were entering the business.

The companies had a tremendous task in terms of getting costs, and I think part of that did come out in tough relations with suppliers, and there were periods when they were better and there were periods when they were worse. I think the recent problems of the suppliers have to do both with the cost side and also with the shrinking of demand. I mean, they -- the domestic suppliers were more dependent on the domestic companies and volume just dropped out of bed.

MR. BAILY: Okay, thank you.

All right, we'll come back to that. I want to throw the thing open for a couple of questions and then we're going to have to close down this session.

Yes, question here.

MR. RATTNER: So, let me be very clear about this, even though I'm not part of the administration. As I think I said in my remarks, there is no interest in using government policy levers to either help or hurt (inaudible) help the companies that were under our care. We looked at it from a financial restructuring point of view. We didn't go to OSHA and say relax the labor standards. We didn't go to EPA and say do this. We didn't try to do anything -- that idea -- those (inaudible) never even were uttered.

The cash for clunkers phenomenon -- look-it, and there are people up here who know more about this than I do, but I'll give you my perspective. You know, people criticize -- I don't actually -- I'm not actually as critical of the Detroit Three for not having made small cars until now, because they were actually behaving incredibly economically rational. They couldn't afford to make them. They had such high legacy costs that on a $20,000 car on which you might a thousand dollars, they couldn't compete. The only thing they could compete on were trucks, SUVs, and large cars. What we think -- the reason why I'm a little more optimistic than you might be about GM's position, vis-à-vis smaller cars, is because we think we've now changed our playing field. We've now made them competitive from a balance sheet point of view. We've made them competitive from an operating cost point of view, witnessed by the fact that they are bringing that 160,000-car -- small-car plant to Michigan rather than doing in Korea. So, our philosophy in the administration is very much to let the market do this and equip the companies to compete and now GM's going to have to go out there and compete.

MR. BAILY: Thank you.

I'd just add a point. The figures you cited I think are misleading. They come from the way the Department of Labor I think -- no, the way NTSA originally reported it, and the way they did that is they separated out two-wheel drive and four-wheel drive vehicles. So, for example, they would not list all Malibus that were sold together; rather, they'd separate them into separate categories, and that's why you got the ranking that showed almost no -- none of the big three vehicles. If you look at separate data that Edmonds has put out that groups them as most people would think about brands, actually the big three did much better. For had many of the top selling models. GM had one in the top ten, too, so I think it's a question of how the data is packaged.

MR. ZIMMERMAN: I just wondered -- Mr. Rattner said that the administration did not think about fuel economy standards while they were doing the restructuring, and I believe that. My question is -- sort of puts in reverse; that is, for other reasons, the administration decides that these are the fuel economy standards. What do the companies do? In the old days, the companies would say well, we can't do that, it's not feasible, it's going to give us a problem. It seems to me they're much constrained by being owned by the government from coming in and saying hey, that's not a great idea.

MR. RATTNER: Well, as I said in my remarks, the new fuel-efficiency standards were developed by EPA and Carl Brown -- are completely separate from what we were doing, and I only really found out about them the day before all of you found about them. They dealt with not just our three -- our two companies and your third one, but all ten or so of the companies that are manufacturing here. The companies I think are actually pretty happy with the outcome, because it solved the dual standard problem between California and the rest of the country, gave them more flexibility. But then I'm not saying they got everything they wanted. I'm just saying that we -- what we were doing with GM and

Chrysler was not a chip on the table for that other discussion. It proceeded separately.

MR. ZIMMERMAN: That I believe.

MR. BAILY: Okay, one more question.

SPEAKER: Yep, could I add just one point on that, because that -- on the question of whether the companies are hamstrung against protests and the fuel economy standards.

MR. BAILY: (Inaudible)

SPEAKER: Based on the fact that the government has been involved, I -- Governor Schwarzenegger I think implied that, and I think it's not true. The much more important factor was EPA clearly had the authority to go ahead with the standard, which would have been as stringent as California's, and the lawyers were all saying the likely outcome of litigation over the California standards was going to be in favor of California. And I think faced with that, those realities, the course the auto companies took and the UAW (inaudible) instead enter into negotiations in a single national standard was the right course and the better one, so I think the fact of the government ownership had very little to do with the outcome.

MR. BAILY: Yeah, okay, one more question and then we (inaudible) here.

SPEAKER: Yeah, my name's Ethan. I'm not a journalist. I'm just a citizen.

MR. BAILY: Speak up a little, please.

SPEAKER: My name's Ethan, and I'm not a journalist, just an interested citizen.

My question is actually about the Chinese portion of General Motors' operations. You mentioned that you think it's going to be pretty important going forward in terms of bringing these companies back to a profit, and my -- I mean, I'm just thinking, it might even grow faster than the American business. Do you think that U.S. government ownership is going to have any effect on that, or did you look at that in terms of, you know, being able to, for example, consolidate so that if it makes to do one thing all in China because maybe more of it sells in China than in the U.S., that they'll be able to that, that kind of thing? Do you under understand my question.

MR. BAILY: I haven't understood the question. Maybe you do.

SPEAKER: Just in terms of the ability to consolidate. So, for example, if China -- you sell a lot of small GM cars, maybe it makes sense to do all of that in China from a business point of view but not maybe from a political point of view. Do you actually believe that it will be possible to -- for General Motors to be able to do that, to do all of its maybe small cars in China if that makes sense from a business point of view because maybe they're selling a lot of them there?

SPEAKER: Well, the only -- look, as I said, you know, almost without exception, we want General Motors to do what is in the interest of their shareholders. There is, as Alan I think referred to -- there are some domestic production limits that were put in as both -- initially as part of the Chrysler deal because of Fiat's involvement. We didn't want to have Fiat's suddenly moving production all over the world to suit them, and our Canadian partners who invested a lot in both of these deals had an interest in maintaining Canadian production, so there is some very kind of rudimentary or modest limits on that. But for the most part, if they decide they want to produce cars in China instead of Brazil, they can do that. And they should.

MR. BAILY: I would like to thank the panel --

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