Domestic Credit by Richard Freeman

Auto industry cooks its books

The Big Three are trying risky gimmicks to hide their illiquidity from the public.

The U.S. auto industry is cooking its books. The public has no sense how severe the liquidity strain on the auto sector really is." This scandal, reported by a source close to the Department of Transportation who weekly monitors the auto industry's accounts, underlines the fact that the auto industry could blow sky high with the next cutoff of credit to the economy, and take with it not only the very large auto supply industry but 50 key Midwestern cities, while engulfing the entire U.S. economy in a chain reaction of bankruptcies.

"First," this source stated, "GM is deferring pension fund pay-ins for a whole portion of its workers, who don't have high seniority." GM justifies this move on the double grounds that some of its laid-off workers don't legally have to be covered by pension fund pay-ins, and that in the future the auto industry will have a "lower labor content," that is, there will be far fewer workers to pay pensions for. GM has also changed its relationship to its auto dealers. "GM used to give its dealerships a 20-day grace period after the delivery of cars from the factory, but it has junked that policy and now demands immediate payment for the cars." By means of these gimmicks, GM will add to its cash flow $400 to $800 million. This gimmick is not repeatable.

Ford Motor Company is pulling the same sort of thing to aid its cash flow. The financially battered Chrysler Corporation had already tried it last year, and this year resorted to other short-term financial games. "Chrysler suppliers agreed to keep their prices low, without passing on the inflation increase." This has saved Chrysler from a 5 to 10 percent or more increase in expenses. Further, Chrysler is three to four months in arrears on payments to its suppliers, and in February owed them more than $100 million for that month alone.

Chrysler workers have also agreed to a $140 million income reduction this year. But Chrysler's financial problems have still persisted and this has not been sufficient. The Carter administration is finding ways to funnel money to cash-strapped Chrysler from many government agencies, including the Federal Home Administration, which ostensibly has nothing to do with auto.

Contrary to the popular misrepresentation of the problem, the auto industry did not "underestimate" the U.S. car-buying public's demand for small cars. The auto industry began putting away funds in 1974, by cutting dividends, for the investment in downsizing cars. But the 1979 Iranian oil squeeze was so large that the pace of the consumer move to small cars was faster than anticipated. The auto companies had already locked themselves into large non-deferrable expenses for downsizing, for excessive pollution and safety standards and the like, when on top of the oil price shock, Federal Reserve Board chairman Paul Volcker sent interest rates into double digits in the autumn of last year.

The industry's cash flow started having problems as early as 1978, and by the early part of this year was in deep trouble. The auto industry, the second largest in the United States, plays a pivotal role for many other industries. Auto consumes 20 to 25 percent of all U.S. steel, 50 percent of the malleable iron, 33 percent of the zinc, 13 percent of the copper and 60 percent of the synthetic rubber. These industries and the large auto-parts supplier industry depend heavily on auto, as their bleak balance sheets show for this year.

Furthermore, in the industrial Midwest, the auto industry is the income lifeline, through tax payments, of the major urban centers. According to this source, "There are 50 cities in the Midwest, in the Flint-Detroit belt, in the Lorraine County, Ohio region and around St. Louis that are in need of going to the public market, but can't." He added, "I mean cities like Hamtramck and Flint in Michigan. The financing pressures on these cities are great. Aside from having to expense out their services, the biggest cost is their debt rollover. The Treasury is scared stiff over the situation, because if they had to handle it like New York City, there would have to be 50 Big MACs."

When the prime was only 11.5 percent a month and a half ago, Chrysler chairman Lee Iacocca said, "If interest rates go higher, we're a dead fish in the water." Despite the impressive sales for the new models for the first ten days of this October, Mr. Iacocca was right.