

The gameplan for U.S. auto

by Richard Freeman

Peter Solomon, a partner in Lehman Brothers, Kuhn Loeb investment bank, reported Dec. 5 that "as many as 400,000 jobs will be lost in the auto industry by 1983." He added that "counting the related industries of steel, aluminum, and rubber, I think residual unemployment could top 500,000." The precision of Solomon's view on this subject reflects the fact that he had just returned from five months of formulating the auto industry's "revitalization plans" as cochairman of the Treasury Department's Auto Industry Task Force for the Carter administration.

According to an informed source close to the Department of Transportation, the plans and legal framework are being drawn up to sell off pieces of a bankrupt Chrysler Corporation.

Whether this policy will be pursued under Ronald Reagan is the central question for the auto industry. If that happens, the auto industry will not survive, at least in a recognizable form.

What is most important is that the auto industry's destruction is not primarily the result of mismanagement, or of the public's car preferences, but of economic warfare. The auto industry's Big Three—Chrysler, GM, and Ford—have been the targets of interest-rate escalation, oil-price shocks and government-mandated environmental standards which, as I documented in the Dec. 9 issue of *EIR*, are heaping huge capital expenditures onto the auto industry's retrenching cash flow.

Selling off Chrysler

The Washington source reports, "Chrysler's loan guarantee stipulates that it must have a profit in the fourth quarter of 1980. That condition and other conditions of the federal government-guaranteed loans for Chrysler have not been met. There is a discussion going on inside government as to whether for political reasons Chrysler should be let go."

The source confirmed that "Chrysler is for all intents and purposes bankrupt, even by the technical definitions. It has negative equity; that is, Chrysler's retained

earnings are larger in the negative than Chrysler's stock is worth. If you look at it, Chrysler really went through a Chapter 11 Bankruptcy reorganization for the first time in the fall of 1979 when it applied for the loan guarantee. The guarantee was for money that Chrysler was supposed to use for capital expenditures. But Chrysler is so desperate they are using the \$800 million they have drawn down of the loan so far as working capital."

This appraisal must consider the fact that in submissions to Congress, Chrysler has already reported that it will cut its operating capacity by half as part of its operating plan. This includes shutting down 20 of the 40 Chrysler plants on the North American continent.

But reports are being widely circulated that unless Chrysler can meet the terms of the government's stipulations on Chrysler's latest application to draw down another \$400 million of the government's \$1.5 billion loan guarantee—there is \$700 million of the loan guarantee remaining—Chrysler will have to sell off parts of the remaining 20 plants that are not slated for closing.

Chrysler's loan guarantee

Chrysler has been hanging by the skin of its teeth since the autumn of 1979, when the groundwork was laid for its \$1.5 billion government-backed loan guarantee. The guarantee covered some of the loans Chrysler already had outstanding, and also provided coverage for some new credit lines that Chrysler would seek from banks.

From the outset, those familiar with the auto industry characterized the loan guarantee as a fraud. Chrysler needed low interest rates, relaxation on Naderite standards, and an investment tax credit, as well as the accelerated tax credit (i.e. tax-payment deferral) Chrysler chiefs John Riccardo and Lee Iacocca were asking for. As long as interest rates remained high, the loan guarantee simply defined a limited borrowing capability for Chrysler, a capability that could not help very much.

Supervising Chrysler's loan guarantee and overall finances is the three-member U.S. Chrysler Loan Guarantee Board established by Congress in December 1979. One member of that board is Paul Volcker himself; the second is Treasury Secretary G. William Miller. (The third member is Comptroller General Elmer Staats.) Both Volcker and Miller are hostile to Chrysler's continued existence and to the auto industry overall, which they deride as a sunset industry.

Chrysler has drawn down \$800 million of the \$1.5 billion, and last week applied for an additional \$400 million authorization. One surly Treasury official told the *New York Times* that "Chrysler will soon see a day of reckoning."

Volcker and Miller held meetings with Chrysler Chairman Iacocca over the last week and laid down \$2 billion in survival condition sacrifices for Chrysler's

getting the \$400 million additional. Chrysler must get:

- \$600 million from the United Autoworkers Union in a pay freeze for 1981. The UAW workers took a \$345 million pay cut in 1980;
- \$240 million saved via a 5 percent cut in prices from Chrysler's suppliers for the first quarter and a price freeze for the rest of the year;
- \$572 million in loans that are not covered by its loan guarantee converted into preferred stock;
- \$575 million in cuts in capital spending for capacity increases for its 1984 and 1985 models and some executive-level attrition.

These "sacrifices" are being heaped upon suppliers, who because of the drop in business are at best keeping their heads above water, and a UAW which has run out of funds to supplement for the growing numbers of its unemployed.

If Chrysler doesn't come up with all these sacrifices, it goes under. But even if it meets this test, it will, under current conditions, fail anyway, and then be dismembered.

"Chrysler will be finished by March," reported Gary Sterns, an economist at the Gary Schilling economic consulting firm Dec. 9. "Some of its parts will bring a lot of suitors. United Technologies or General Dynamics," Sterns explained, "would be very happy with Chrysler's defense section. That will be grabbed up right away."

The Department of Transportation source confirmed that "Chrysler attorneys, Treasury official attorneys, and sources from a hundred other places have already worked out the legal plans for the sale of the key Chrysler divisions on a moment's notice, without the slightest legal delay. Chrysler's defense-aerospace division is a good point. It is just barely a Chrysler subsidiary, and could be transferred to some other corporate entity without any legal difficulty from the government."

Other parts of the Chrysler system that are being slated for purchase:

- Chrysler's new process gear plant in Syracuse, New York, which produces most of its gears not for Chrysler cars, but for vehicles of companies around the world;
- Chrysler's \$600 million transmission plant at Kokomo, Indiana, which includes some of the most modern automotive equipment in the country;
- Chrysler's L and K car plants, which produce the Omni, Aries, and Reliance compact cars.

According to the Department of Transportation source, "joint ventures will be formed, which will allow outside interests to invest money and get half ownership of L and K car plants. They will not be bought outright."

And what happens to the remaining Chrysler assets? "If someone wants a plant cheap, they can buy it,"

reported the source.

Reports Schilling's Stern, "nobody will buy the Chrysler assets right away. They'll wait until they're good and cheap."

Ford and GM

Putting Chrysler through the wringer just prepares the ground for wringing out the rest of the American auto industry.

Ford Motor Company is experiencing tremendous problems. According to one source, "For the 1979 model year, Ford Motor Company produced 2.5 million cars and 1.2 million trucks in the U.S.; and in the 1980 model year, it produced 2.3 million cars and 1.2 million trucks; but for 1981, Ford has set-up capacity, that is, capacity that it is providing workers for, for only 1.7 million cars and 0.7 million trucks. Thus instead of the 3.5 million units of 1979, it will produce only 2.4 million units in the U.S. in 1981."

Ford is attempting to try to get cash from wherever it can. Earlier in the year, it took accelerated dividends and loans from its German subsidiary (Ford's major production center in Europe), which is geared up to produce 900,000 units, but has been suffering very bad sales. To pay back the loans to its German subsidiary, Ford took out \$725 million in loans two weeks ago in the U.S., on which it is paying \$300,000 per day alone in interest. Ford has a \$2.5 billion line of short-term and revolving credit, which it taps from time to time, but to cover its losses in North America, which will probably hit \$2 billion this year, and to meet capital expenditures, Ford may have to go to the market for \$2 to \$4 billion soon. Ford cars have a \$400 to \$500 profit margin per car, and at current interest rates, each \$1 billion in borrowing adds about \$75 per car; a \$4 billion borrowing, if interest rates keep where they are, will cost Ford \$350 per car in additional interest expense, all but wiping out the profit margin.

General Motors, despite greater access to capital than either Ford or GM, is now experiencing acute problems. Its primary cash flow, which consists of cash inflow (profits, depreciation, and amortization set aside) minus cash outflows (capital spending, dividend payouts, long-term debt payments), will be negative \$4 to \$6 billion this year. When it is considered that its primary cash flow will probably be positive for GM's overseas operations, then the extent of GM's North American primary cash flow losses stand out.

Because of its huge cash resources, GM has been able to draw cash out of the nooks and crannies of its organization. Moving up by 20 days its dealers' date for payment on GM-delivered cars has added \$1.5 billion to GM's cash flow. But the auto industry is still faced with \$90 billion in capital expenditures between 1977 and 1985, of which approximately two-fifths are for Naderite-mandated restrictions.