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Bankrupt: An Ethical Analysis of the 2009 Auto Bailout

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Abstract

The three major Detroit-based manufacturers of the American automotive industry, General Motors, Chrysler and Ford, are jointly referred to as the Big Three for distinguishing their operations from those of competitors in terms of size, sales, geography and profits. In early 2009, the U.S. Government handed the Big Three an initial bailout package worth $25 billion to rescue them from bankruptcy (Isidore, 2008).

Through an analysis of the ethics behind government bailouts and an evaluation of arguments for and against the decision to give out such a package to the auto firms, this paper argues that, given the circumstances in which the decision had to be hastily made, it was morally justified for the U.S. government to reward them a bailout package. These circumstances, however, could have been avoided had the auto industry not disregarded the outcomes of its prolonged indulgence in corporate malpractices. Thus, if no lesson is learnt from this recession and such neglect continues, the Big Three, or any other corporation for that matter, should not be allowed access to such enormous amounts of public funds in the future.

Background

Prior to the Federal Deposit Insurance Act (FDIA) of 1950, federal regulators could take only one of two approaches for dealing with an insolvent corporation: force permanent closure of the firm, or encourage other firms to purchase the dissolved one. The FDIA made it possible for the government to provide assistance to firms through loans and asset acquisition until they recovered and performed better. As this third option involves the directing of public money into salvaging private corporations, its application has been a highly contentious matter since the act was passed.

Beginning 2001, the Detroit automakers' profits started to sink as oil prices began to rise, a trend that was only worsened by the 2007 financial crisis. Despite substantially reducing their workforces and closing operating units nationwide, the automakers were not able to cut costs enough to ensure gains in the declining market. In Fall 2008, as the recession continued and automotive sales plunged, the Big Three—

saddled with high legacy costs—speedily burnt through their once plentiful cash reserves. In September 2008, when the three firms finally approached the U.S. government in desperate need of funds to avoid bankruptcy, the Congress issued them a $25 billion loan in installments through March 2009, alongside committing to sponsor the warranty liabilities of GM and Chrysler if the companies were to go out of business (Reuters, 2009). These loans and fiscal backings provided short-term operating cash for the firms and kept auto-loans available for future consumers.

But the approval of this enormous bailout package gave rise to widespread debate concerning the ethics of governments aiding firms in distress. Those who stood behind the approval argued on consequentialist grounds that allowing firms to go bankrupt would have created severe, long-term effects. Those who argued against the bailouts based their reasoning on the principles of distributive and retributive comparative justice. They claimed that since the Detroit manufacturers brought about their own misfortune through corporate malpractice, the market should have brought them to their just end. Bailing them out was unfair for competitors who had worked to change with the market and kept their firms efficient and free from malpractices. The following sections of this paper discuss arguments for both sides in an attempt to reach a reasonable conclusion on the matter.

Ethical Arguments for the Bailout Appealing to the utilitarian theory of decision-making, proponents of the bailout package ask us to consider the percentage of GDP and the number of jobs dependent on the existence of giant companies at the time, which were the Big Three.[1] After establishing how significant a role the three firms played in determining these critical factors, proponents posit the negative effects that bankruptcy would have had on the country's GPP and the jobs dependent on the existence of the Big Three. Since the only viable way to avoid these negative effects, at least at the time the appeals were made, was external aid, utilitarians argue that the government was not only justified, but morally obliged to assist the falling firms so as save the innocent common man.

This argument demands serious consideration due to the sheer amount of stakeholders that would have been gravely affected by the firms going bankrupt. According to the Center for Automotive Research, at the time of appealing, a collapse of the Big Three would have triggered close to 3 million layoffs within a year and substantially worsened the on-going economic recession (McAlinden, Dziczek & Menk, 2008, p 4). Hampered economic growth from the multibillion dollar loss in revenue from sales would have, in turn, affected the living standard of all Americans. In addition, the termination of the Big Three's U.S. operations in 2009 would

[1] As of beginning 2011, the auto industry contributes 3.6% or $500 billion to total U.S. GDP output, and employs 850,000 workers in manufacturing, with another 1.8 million workers in auto dealerships (U.S. Bureau of Labor Statistics, 2011).

have registered a total government tax loss of over $156.4 billion over the following three years (McAlinden, Dziczek & Menk, 2008, p 5). Since money obtained from taxes is chiefly utilized for the upkeep and upgrade of services for the general public, a sizable decline in taxes—like that if the Big Three were wiped out—would have meant a decrease in the quality and quantity of public services for the common American.

The list of stakeholders that would have been affected by a crumbled auto industry does not end here. American auto manufacturers are the country's largest purchasers of plastic, iron, aluminum and a plethora of other raw materials (Gmblogs, 2008). A stark reduction in consumption of raw goods brought about by an auto industry crash would have inevitably affected manufacturers of these materials. In turn, international trade and collaborating economies would have suffered. Moreover, apart from a very likely economic catastrophe, an industrial collapse could have turned into a national security threat and blow to the country's stability as consumers lost faith in the U.S. government's ability to maintain a healthy economy.

In light of this, a $25 billion dollar loan to avert a future catastrophe worth approximately $156 billion—the combined monetary costs of all economic effects listed above (Gmblogs, 2008) —was surely a rational choice. A bankruptcy at these companies would have proven far more expensive for taxpayers than the amount of money asked to be loaned out. In fact, ensuring that the general population is least harmed by the economic downturn becomes a responsibility, an obligation, on the part of the government. Therefore, utilitarians argue, the government was morally bound to bail out the failing corporations so as to ensure the welfare of its people.

A second argument advanced by supporters of the auto bailouts, and the chief condition on which the government based its $25 billion loan through the Department of Energy, was that the money would help the Big Three retool and restructure their factories to produce technologically advanced vehicles that met new emissions and fuel-efficiency standards (Calamari, 2008). Furthermore, the funds carried instructions from the government that required the three firms to immediately cut down excesses such as overproduction, expensive rebates, and bloated vehicle lineups (Vlasic, 2010, p. A1). These conditions seemed to have been put in place in order to push the firms to improve both their technology and former corporate practices, thereby achieving a new global competitiveness—justifying the government's decision to provide aid on the basis of the Extreme Paternalism Principle (McGinn, 2011).

Thus, taking into consideration the fate of workers who faced the danger of being laid-off, the harm which the American economy and other industries dependent on the health of the Big Three stood to face, and the bleak prospects of corporations that had contributed significantly to the country's economic growth in the past and had long been held as symbols of national pride, supporters argued that it was acceptable and, in fact, necessary for the government to step in and save the Big Three from bankruptcy so as to ward off the negative consequences that might have befallen nation and others otherwise.

Ethical Arguments Against the Bailout

On the other hand, drawing on various frameworks of justice, opponents of the bailout argue that the Big Three offered no reasonable explanation for the inefficient and corrupt practices that brought them to the verge of bankruptcy. They did not deserve any form of assistance from the government to improve their situation, argue opponents, let alone aid using money from the pockets of taxpayers, when this same money could have been used to alleviate the distress of the common man who did little to create the ongoing recession and yet was suffering from its effects. In knowing their privileged position as companies that were too big to bear the full consequences of their actions, the institutions behaved in a far less responsible manner than they would have had they not known that the government or the general public would be sharing the burden of the consequences with them. Indeed, the auto firms' decisions seemed to be a case of moral hazard, in which they treated the large size of their operations and assurance of government assistance in the case of failure as insulation from risk, behaving differently from how they would have had they been fully exposed to the risks of a free-market. This stands in absolute contradiction to the counterfactual proposition that justifies the application of Rawl's Difference Principle. For instance, in order to improve profits, the Detroit automakers made agreements with United Auto Workers to reduce labor wages while making pension and health care commitments in terms of shares (Henning, 2004), shares that would lose all value if the corresponding companies went bankrupt and were to need external aid to be honored.[2] Since it was the unabated presence of such internally devised policies that ultimately brought about the collapse of the Big Three, opponents argued that it was non-comparatively retributively just (McGinn, 2011) for the three firms to bear the consequences of their own misdoings.

Another argument posited by opponents of the bailout highlights the stakes of taxpayers in the issue. Government assistance could have been used, for example, to improve public amenities, thereby serving the legally protectable basic human physiological and security needs of the citizens. Thus, the act of using taxes to instead aid private companies invoked the prospective public Harm Principle (McGinn, 2011), since not using taxes to relieve millions of Americans from the distress of recession ultimately harmed the entire general public.[3]

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[2] The United Auto Workers, or UAW, is a major labor union that represents over 390,000 workers throughout the United States, Canada and Puerto Rico.

[3] The prospective public Harm Principle is an extension of J.S. Mill's Harm Principle, which holds that "the only purpose for which power can be rightfully exercised over any member of a civilized community, against his will, is to prevent harm to others" (2011).

In addition, the reverse Robin Hood attitude adopted by the government in collecting public funds through taxes and then spending disproportionately large amounts to salvage these corporations was undoubtedly distributively unjust. During an economic downturn like the one happening when appeals were made, the average citizen, not corporations, is in greater need of subsidies and welfare. The reason for this is a basic, morally relevant difference between the two: the survival of a citizen entails the preservation of life, whereas the survival of a corporation simply means preserving assets such as factories and inventory from being liquidated. Interpreted in this way, any government decision which favors corporate welfare over a citizen's well-being essentially devalues human life, and is therefore ethically unjustified.

It is the Big Three who brought themselves to near-bankruptcy by not operating competitively for years and not adapting to an energy efficient era; they delayed manufacturing alternative energy vehicles, and instead stuck to reaping profits from SUVs and Hummers (Amadeo, 2009). It is not the government's obligation to bail them out. The bailout was a comparitively and distributively unjust solution to the bankruptcy issue because it rewarded failure and penalized success by giving enormous amounts of aid to collapsing firms while leaving successful firms at the status quo.

In the aftermath of a deal that allowed the Big Three access to steep concessions on labor wages, Ron Gettelfinger, President of UAW, announced that "all stakeholders have to participate in shared sacrifices to help the industry move forward" (Kerson, 2008). Although it may have indeed been more practical if the burden of corporate failure had been shared amongst numerous stakeholders instead of just one, Rawl's Difference Principle would have prohibited the *equal* sharing of such burden amongst all concerned parties. Instead, this principle of justice would have required that the social bad, which included the sacrifices expected to be made by stakeholders in order to improve the situation, was distributed in a manner that those worse off, already financially burdened Americans, were disadvantaged the least as a result of the distribution. Acts of corporate welfare using taxpayers' money ultimately resulted in the common man bearing a major proportion of the social bad, and were thus unjustified, especially when the disadvantaged in this scenario were also the innocent who played a negligible role, if any, in producing the corporate collapse.

Analysis and Resolution

From the arguments illustrated in the previous sections, it is clear that these two positions differ not only in the line of reasoning each employed to reach their respective conclusions, but also in the particular elements of

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When this harm is prospective in nature, rather than actual, and has the potential to affect people other than the perpetrator(s) alone, the prospective public Harm Principle is invoked.

the issue on which each chose to ground their reasoning. In essence, while the opinions of those who opposed the bailout and instead demanded retributive justice concentrated on *what had been done*, the views of those who advocated the bailout as a form of economic damage control concentrated on *what should have been done*. The key point to note here is that at the time the decision for the bailouts was made, the harm had already been done. The failure on the part of executives to successfully manage their companies had already taken place. Leaving the companies to their own fate at this point would have only resulted in more lives being damaged – through unemployment affecting laborers and further recession affecting the general American population—thus making a decision against the bailout incongruent with the prospective public Harm Principle (McGinn, 2011). In light of these facts, I believe that the government was justified both ethically and in a pragmatic sense in allocating tax money for bailing out the distressed firms. Aside from perhaps satisfying a desire for vengeance, imposing a penalty on the corporate executives would not have substantially helped the troubled economy or unemployed workers. In fact, although retributive justice at that point might have proven a deterrent for similar transgressions of the law in the future, it would have negligibly contributed to alleviating the struggles faced by people as a result of the Big Three collapsing. Furthermore, it is important to realize that the company executives in power at the time the bailout was requested could not be wholly blamed for the corporate collapse. It is possible, and rather likely, that the then managers merely inherited a quagmire of mistakes which had accumulated over several decades, meaning that the responsibility for the firms' failing was shared by many previous managers of the company as well. Solely punishing the executives at the time of the crisis for what were the mistakes of many would not have been comparatively retributively just either.

At the time of the bailout, the auto industry employed about 850,000 workers in the manufacturing sector who stood to lose their jobs immediately if the bailout were not approved (U.S. Bureau of Labor Statistics, 2011). While opponents of the bailout point out that the bailout protected the jobs of only a few hundred thousand people while reducing the disposable incomes and spending power of millions of Americans, without a doubt a comparatively distributively unjust scenario, one needs to examine these numbers further in order to accurately gauge the extent to which the bailout is distributively just. The few hundred thousand workers who would have lost their jobs, a nontrivial number of people in itself, had at stake their livelihoods, their monetary assets, and their family's present and future well-being. In comparison, reducing the disposable income of other Americans, although they number in the millions, only meant that they lost a potentially higher quality of life while retaining a standard of living that still ensured the availability of basic human needs like food, clothes, shelter and safety.

It is important here that one considers whether the interests at stake of a few trump the interests at stake of many. I believe that any government which genuinely cares for its people will not leave them devoid of basic, human needs, even if they are the minority, so that the majority is guaranteed a plentiful lifestyle. From this perspective, it is clear that the government's decision to bail out the three firms, and thereby save the jobs of auto workers, was in fact a comparatively distributively just solution.

Moreover, the bailed out auto firms were still responsible for repaying the government a partial amount of the loan once they achieved financial stability, with GM having already paid $6.7 billion of its debt as of January, 2010 (Thomas, 2010). Thus, the taxpayers eventually recouped billions of dollars directed towards the bailout, all without the loss of numerous jobs or a significant fall in the GDP. Once again, opponents were indeed correct in arguing that this repayment would only be partial, and that a considerable amount of the package would simply end up being a free giveaway. But it is essential to note that it is the responsibility of the government to look after the security and well-being of its citizens, of which the corporate executives, the workers and, in fact, the corporations themselves, constitute a part.[4] By bailing out the firms, the government merely directed its discretionary funds from taxes into helping out a part of the population that it was responsible for to cope up with distressing circumstances.

Conclusion

One must note here that the government made it a point to put a firm condition on the loans given out that, by the end of 2009, the Big Three would reduce the wages and benefits of their management and modify their work rules to make them more competitive with those of foreign car companies in the United States like Toyota and Honda. Developing fuel efficient and environment-friendly hybrids were yet other directives included in the bailout. Thus, the bailout was more than just a short-term salvaging of desperate firms by the government; it was a well thought out and far-sighted initiative that aimed at not only improving the present situation, but also making the entire American auto industry better and more competitive internationally in the long-run.

A clear message, however, must be sent out to all big corporations—whether bailed out or not—that simply because it was justified for the government to rescue the firms under the circumstances prevailing in 2009, it must not be taken as a guarantee that such leniency would be shown while dealing with failing firms in the future. It was still justified to penalize the then executives of the Big Three to the extent that the

[4] In the 1886 case *Santa Clara County v. Southern Pacific Railroad*, 118 U.S. 394, the Supreme Court declared that corporations were to be recognized as persons entitled to protection under the Fourteenth Amendment (*The Superior Court of California, County of Santa Clara*).

corporate failure was their fault. It was still justified for the prevailing management structure and business policies of the firms to be replaced with those that would prove beneficial for the entire economy instead of just a handful of top-tier leaders. Indeed, since one of the primary reasons for helping the three auto makers was their huge size and their stand-alone contribution to the nation's employment and economic levels, in the future, firms should be progressively taxed based on size so as to internalize costs inflicted by the too-big-to-fail institutional paradigm (Buiter, 2009). Though fiscal intervention by the government will go a long way in improving the conditions of the auto industry, it is only when such aforementioned initiatives are in place that the U.S. industrial system would be able to prevent a Neo-Darwinist environment which assures the survival of the fattest, and instead, implement one that assures the survival of those that contribute the most to the advancement of American society.

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