Chairman McHenry, Ranking Member Quigley, and members of the subcommittee: It is my pleasure to testify today on matters related to the Obama administration’s Automotive Task Force and to the refusal of former Automotive Task Force members to cooperate in efforts to understand the task force’s controversial decision to “top-up” Delphi Corporation’s pension plan for Delphi employees who were members of the United Auto Workers (UAW) labor union. General Motor’s decision to guarantee the obligations of a separate company—Delphi—was completely unjustified under established principles of bankruptcy law, and it increased the cost of the taxpayer bailout of the automotive industry by more than $1 billion with no reciprocal benefit to General Motors (GM). I commend this committee for seeking answers to this unexplained behavior by the Automotive Task Force.

The bankruptcy and bailouts of Chrysler and GM were unprecedented in the number of blatant irregularities and in their abuses of the bankruptcy system. For Chrysler, for example, the U.S. government orchestrated a bankruptcy case that ran roughshod over established principles of bankruptcy law to plunder the interests of secured creditors—including most notably the Indiana State Teachers and Police Officers retirement funds—in order to transfer funds to the UAW as an unsecured creditor. Moreover, according to a study by Blaylock, Edwards, and Stanfield, this politically motivated violation of one of the fundamental principles of bankruptcy weakened the enforcement of creditor rights in the economy, leading to an increase in borrowing costs.\(^1\) In addition, rather than permitting a fair and open auction that would have maximized the value of the bankruptcy estate for all creditors, the government imposed extraordinary restraints on the auction process that required competing bidders to prefer the claims of the UAW’s Voluntary Employees Beneficiary Associations (VEBAs) and deterred competing bidders.\(^2\) The bankruptcy cases themselves featured extraordinary levels of politically motivated interventions by politicians seeking to curry favor with constituents rather than to maximize the success of the reorganizations.\(^3\)

Much of the government’s political intervention in the bankruptcy cases appears to have been motivated to benefit the UAW rather than the companies themselves over U.S. taxpayers, who put billions of dollars at risk to fund the bailouts. The taxpayers spent a total of $80 billion on Chrysler, GM, and GM's finance arm Ally Financial. A substantial amount of these funds will never be repaid. The government has already written off or realized losses of more than $7 billion. More losses will be realized as the government sells its remaining stake in GM and Ally Financial. The U.S. Department of the Treasury projects that, at GM’s current stock price, taxpayers will lose $23 billion. It also estimates that taxpayers will lose $23 billion from its venture into the auto bailouts. To get a better sense of the size of those losses to the taxpayer, that amount substantially exceeds NASA's annual budget and the annual budget for all foreign aid programs and is approximately the size of the annual budget of the state of Missouri.

It would be one thing if these huge losses had been necessary to facilitate the bankruptcy reorganization of the auto companies. But, according to a recent paper by James Sherk and me (a copy of which is enclosed with this testimony), the entire loss to the American taxpayer was not necessary to save the U.S. auto industry. Instead, the entire loss is attributable to preferential treatment provided to the UAW in the bankruptcy cases beyond what they would have received as creditors and employees in a typical bankruptcy case. In total, this transfer from taxpayers to the UAW amounts to approximately $26.5 billion. Had the UAW been treated the same as other similarly situated parties in these and other bankruptcies, there would have been no loss to the taxpayers.

We document three ways in which the UAW was given unjustifiably preferential treatment in the bankruptcy cases. First, the UAW VEBAs plans, which had unsecured claims in the Chrysler and GM cases, were given better treatment than other unsecured creditors in those cases. At the time of bankruptcy, GM owed these unsecured creditors $29.9 billion, for which they received 10 percent of the stock of “new” GM, which went public in November 2010, and warrants to purchase 15 percent more at preferred prices. Yet the Veba received 17.5 percent of new GM and $9 billion in preferred stock and debt obligations. Based on GM’s current stock price, the Veba collected assets would be worth $17.8 billion—that is $12.2 billion more than if it had been treated like the other unsecured creditors in the case.

The same thing happened at Chrysler, only to a greater degree. Chrysler’s junior creditors recovered none of their $7 billion in claims. In normal bankruptcy proceedings, the UAW would have also collected nothing. Instead, it

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5. Id. The Congressional Budget Office (CBO) estimated that the auto bailout will ultimately cost taxpayers about $20 billion, based on a share price for GM of $23.35 (price as of November 15, 2011). Any differences in the estimates among the CBO, Treasury, or any figures presented in this testimony or the accompanying report are entirely mathematical: A lower GM share price increases the loss to the taxpayers and reduces the size of the giveaway to the UAW. At all relevant times, however, the size of the transfer to the UAW has exceeded the total loss to the taxpayers. For example, the calculations used in this testimony are based on GM’s opening share price on May 1, 2012 and converted to present value terms (see attached report for details). Since May 1, GM’s share price has fallen from $23.04 to $20.30, increasing the taxpayer losses to $24.06 billion and reducing the UAW subsidy by about $350 million.
6. These estimates exclude other indirect losses that increase the cost of the bailouts, such as the unusually preferential tax treatment provided for carryforward of next operating losses in these cases, which allowed GM to carry forward $45 billion in net operating losses, an asset estimated to be a $16 billion windfall to GM, which by increasing GM’s share price also implicitly increases the size of the transfer from taxpayers to the UAW proportional to the size of their stock holding. See Eric Bennett Rasmusen and Mark J. Roe, “Can the Treasury Exempt Companies It Owns from Taxes? The $45 Billion General Motors Loss Carryforward Rule,” in Cato Papers on Public Policy (Jeffrey Miron, ed., Cato Institute, 2011).
8. The Veba is formally called the UAW Retiree Medical Benefits Trust. Although technically a separate entity, the UAW Veba exists solely to provide benefits to UAW members, and the terms UAW and UAW Veba are used interchangeably in this testimony.
walked away owning almost half of new Chrysler and a $4.6 billion promissory note earning 9 percent interest. Had the stock and note gone to the U.S. Treasury—which actually provided the money—instead of the UAW, Mr. Sherk and I estimated that the bailout would have cost taxpayers $9.2 billion less.

Second, the political bankruptcy also insulated the UAW from most of the sacrifices that unions usually make in bankruptcy—and at taxpayer expense. Section 1113 of the U.S. Bankruptcy Code enables reorganizing companies to improve their post-bankruptcy competitiveness by renegotiating union contracts to competitive rates. In April of this year, for example, American Airlines proposed using this power to bring down its labor costs to the level of its rivals, just as Delta and United Airlines had in earlier bankruptcy filings.

This did not happen in GM’s bankruptcy. The UAW did accept pay cuts—for new hires. But they only made modest concessions for their existing members, such as eliminating the much-maligned Jobs Bank, which paid workers even when they were laid off. As a result, GM still has higher labor costs ($56 per hour) than any of its competitors. In fact, Steven Rattner, the Obama administration’s former “car czar,” admitted to the Detroit Economic Club last December, “We should have asked the UAW to do a bit more. We did not ask any UAW member to take a cut in their [sic] pay.”

Had bankruptcy brought GM compensation in line with its competitors’ (approximately $47 per hour), we estimate the resulting cost savings would have increased the value of the taxpayers’ stake in GM by $4.1 billion. This would still leave UAW members making 40 percent more than the average American manufacturing worker.

Third, UAW members also received preferences at Delphi, the auto parts manufacturer and former GM subsidiary—one of the matters being investigated today. When GM spun off Delphi, the automaker agreed to supplement Delphi’s UAW members’ pensions if the company went bankrupt. Delphi did go under, and in 2009 filed to have the Pension Benefit Guarantee Corporation (PBGC) take over its pension plan.

When the PBGC takes over pension benefits, it guarantees them but only to a certain limit. When Delphi filed for bankruptcy the maximum pension benefits were $54,000 a year for retirees aged 65 and older, with lower benefits for early retirees. About half of Delphi’s union and non-union workers faced reductions in their pension benefits.

New GM no longer had an obligation to supplement the Delphi pensions. After all, Delphi was an entirely different and independent company after the spin-off, and any obligations owed to Delphi employees were purely contractual relationships with the employees of an independent company. Thus, the bankruptcy filing eliminated any continuing obligation owed by GM to Delphi’s employees. However, new GM’s management—while being overseen by the Obama administration—nonetheless agreed to spend $1 billion to supplement the pensions of Delphi’s UAW retirees. Other hourly employees and all employees in Delphi’s salaried pension plan were not as fortunate: GM did not supplement their pensions. According to a U.S. Government Accountability Office report, approximately 28,500 employees were covered by the GM give-away to Delphi’s UAW employees, and about 41,000 were not.

Had new GM treated Delphi’s UAW and non-union employees equally, the Treasury could have paid $1 billion less for the GM bailout. Instead, some workers became more equal than others.

11. Id. at Fig. 4.
GM employees who belonged to other unions received particularly harsh treatment. Approximately 2,500 employees at GM’s Moraine, Ohio, assembly plant belonged to the International Union of Electrical Workers (IUE). When GM negotiated its 2007 contract with the UAW, it agreed to transfer work from Moraine to UAW facilities. The bankruptcy deal that the Obama administration oversaw barred these laid-off IUE members from transferring to any of the UAW facilities. While GM has rehired many laid-off UAW members, IUE employees have remained on the sidelines.12

As noted above, Mr. Sherk and I have determined that, had the UAW been treated according to standard bankruptcy principles, the cost of the automotive bailouts to U.S. taxpayers would have been $26.5 billion smaller. In light of the Treasury’s estimate that the government will lose $23 billion on this investment, we conclude that the entire loss to the taxpayers is the result of preferentially favorable, and completely unjustified, treatment of the UAW in bankruptcy.

Even leaving aside all of the other irregularities of the bankruptcy cases that were taken to advance the interests of UAW members over other claimants in the cases—including other retirees such as teachers and police officers who held secured bonds in Chrysler—the government still could have avoided a massive loss of taxpayer funds if it had simply treated the UAW according to standard bankruptcy rules. Of these irregularities, GM’s decision to top-off the pensions of Delphi’s UAW employees—and only UAW members of Delphi—is among the most inexplicable. I commend this subcommittee for seeking answers to this billion-dollar question.

Thank you for the opportunity to testify today. I look forward to your questions.


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