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*CONGRESSIONAL TESTIMONY*

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**Auto Bailout or UAW Bailout?  
Taxpayer Losses Came from  
Subsidizing Union Compensation**

**Testimony before  
Committee on Oversight and Government  
Reform  
United States House**

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Chairman Mica, Ranking Member Connolly, and Members of the Committee on Oversight and Government Reform, thank you for inviting me to testify this morning. My name is James Sherk. I am a Senior Policy Analyst in Labor Economics at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.<sup>1</sup>

The government bailout of General Motors (GM) and Chrysler between 2008 and 2009 will cost taxpayers between \$17 and \$20 billion. The entirety of these losses occurred because the Administration gave the United Auto Workers (UAW) special treatment. The UAW recovered far more in the bankruptcy than it had a legal right to:

- Legally, the UAW's claims had the same status as those of other unsecured creditors, but the UAW recovered a much greater proportion of the debts that General Motors and Chrysler owed the union.
- Bankruptcy typically brings uncompetitive wages down to competitive levels. However, existing UAW members did not take pay cuts at General Motors.
- The restructured General Motors used taxpayer funds to “top up” the pensions of unionized retirees at Delphi, its bankrupt former parts subsidiary. New GM had no legal obligation to do so and nonunion employees did not receive similar benefits.
- These subsidies to UAW compensation cost taxpayers \$30.0 billion—more than the government spends each year on foreign aid or on extended unemployment insurance benefits. They account for the entire net taxpayer losses in the bailout.

UAW members at General Motors and Chrysler are among the most highly paid workers in America. High salaries are good, but they must be earned. The taxpayer losses came from the special treatment that President Obama bestowed on the UAW. The auto bailout was actually a UAW bailout.

## **Detroit Bankruptcy**

General Motors, Chrysler, and Ford were in serious trouble well before the recession started. Decades of mistakes by both unions and management had saddled the firms with massive debts, unsustainable labor costs, product-quality problems, and an overgrown dealer network. Yet Ford mortgaged its assets, began to restructure in 2007, and did not need a bailout. The recession brought these problems to a head at GM and Chrysler. As consumers cut back on discretionary purchases—like cars—both firms ran out of money. To become profitable again the automakers needed to restructure through bankruptcy, removing obligations they could no longer afford.

GM and Chrysler instead asked Washington for a taxpayer bailout. The Bush Administration used the Troubled Asset Relief Program (TARP) to loan GM and

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<sup>1</sup> This testimony is adapted from a Heritage Foundation *Backgrounder* of the same name co-authored with Todd Zywicki. The report was initially published in June 2012 and updated in June 2013. As with this testimony, the *Backgrounder* does not reflect an official view of the Heritage Foundation.

Chrysler enough money to stay operational for the first several months of the Obama presidency. To his credit, President Obama denied the automakers the straight-up bailout they asked for. Instead, the Obama Administration forced the companies into bankruptcy as a condition of receiving government support and funded them through the bankruptcy process. The bankrupt automakers sold their assets to new "General Motors" and new "Chrysler"—companies created, capitalized, and partially owned by the government. The taxpayers spent a total of \$80 billion on Chrysler, General Motors, and General Motors' finance arm, Ally Financial.<sup>2</sup>

A substantial amount of these funds will never be repaid. The government has already written off or realized losses of over \$11 billion.<sup>3</sup> More losses will come as the government sells its remaining stake in GM and Ally Financial. The Congressional Budget Office estimates that the auto bailout will ultimately cost taxpayers a total of about \$17 billion.<sup>4</sup> The Treasury Department is even more pessimistic and projects that taxpayers will lose \$19.6 billion.<sup>5</sup>

These losses could have been avoided. The administration could have kept both GM and Chrysler operating without losing any taxpayer dollars had it not given preferential treatment to the United Auto Workers. Instead the UAW fared fare better than unions typically do in bankruptcy cases. This preferential treatment explains the entirety of the taxpayer losses.

## **Bankruptcy Liabilities**

General Motors and Chrysler had substantial liabilities entering bankruptcy—a major reason they went bankrupt in the first place. General Motors owed \$6 billion to secured creditors and \$30.2 billion to unsecured creditors. Chrysler owed \$6.9 billion to first-lien secured creditors and \$2 billion to second-lien secured creditors.<sup>6</sup> Chrysler also owed

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<sup>2</sup> U.S. Department of the Treasury, "Troubled Asset Relief Program (TARP): Monthly Report to Congress—April 2013," May 10, 2013, Figure 2, <http://www.treasury.gov/initiatives/financial-stability/reports/Documents/April%202013%20Monthly%20Report%20to%20Congress.pdf>.

<sup>3</sup> U.S. Department of the Treasury, "Troubled Asset Relief Program (TARP): Monthly Report to Congress—April 2013," Figure 1.

<sup>4</sup> Congressional Budget Office, "Report on the Troubled Asset Relief Program—May 2013," May 23, 2013, p. 6, [http://www.cbo.gov/sites/default/files/cbofiles/attachments/44256\\_TARP.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/44256_TARP.pdf).

<sup>5</sup> U.S. Department of the Treasury, "Troubled Asset Relief Program (TARP): Monthly Report to Congress—April 2013," May 10, 2013, Figure 2. See also footnote 1 on the page following the figure, which shows that the gain in GM share prices between March 31 and April 30 reduces taxpayer losses from \$20.28 billion to \$19.55 billion.

<sup>6</sup> Congressional Oversight Panel, "September Oversight Report," September 9, 2009, Figures 1 and 2, <http://cybercemetery.unt.edu/archive/cop/20110402043042/http://cop.senate.gov/documents/cop-090909-report.pdf> (accessed May 31, 2012). The bankruptcy courts have recognized \$30.2 billion (not the initial \$27 billion estimate) in claims against GM. See Motors Liquidation Company GUC [General Unsecured Creditors] Trust, "Form 8-K - GUC Trust Quarterly Section 6.2(C) and Budget Variance Report as of March 31, 2013" April 23, 2013, <https://www.mlcguctrust.com/Download-KeyDocument.aspx?Document=81>.

about \$5 billion to unsecured trade creditors, and owed billions more in obligations to dealers and for warranties.<sup>7</sup>

The United Auto Workers had also created significant liabilities for the automakers. The union raised Detroit's labor costs 50 percent to 80 percent above that of the transplant automakers, such as Toyota and Nissan. In 2006, General Motors paid its unionized workers \$70.51 an hour in wages and benefits. Chrysler paid \$75.86 an hour.<sup>8</sup> These costs put the Detroit automakers at a significant competitive disadvantage.

Detroit's higher labor costs also included generous retirement and health care benefits. UAW employees at GM and Chrysler can collect pensions in their 50s.<sup>9</sup> The automakers also provided UAW retirees with full health coverage until they became eligible for Medicare. At that point UAW retirees collected generous additional health coverage from the automakers on top of Medicare. While the average Medicare recipient spends \$4,200 a year out of pocket,<sup>10</sup> UAW retirees in 2011 had maximum out-of-pocket expenses of \$285.<sup>11</sup>

To reduce the financial burden of these benefits, the Detroit automakers negotiated a Voluntary Employee Beneficiary Association (VEBA)<sup>12</sup> with the UAW in 2007. The VEBA—funded by the automakers and partially controlled by the UAW—assumed financial responsibility for retiree health benefits. When General Motors filed for bankruptcy in 2009 it owed \$20.6 billion to the UAW Retiree Medical Benefits Trust.<sup>13</sup> Chrysler owed the VEBA \$8 billion.<sup>14</sup> These obligations were unsecured.

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<sup>7</sup> Deniz Anginer and A. Joseph Warburton, "The Chrysler Effect: The Impact of the Chrysler Bailout on Borrowing Costs," paper presented at the Federal Reserve Bank of Cleveland's Conference on Resolving Insolvent Large and Complex Financial Institutions, April 14–15, 2011, p. 8,

[http://www.clevelandfed.org/research/conferences/2011/4-14-2011/Anginer\\_Warburton.pdf](http://www.clevelandfed.org/research/conferences/2011/4-14-2011/Anginer_Warburton.pdf).

<sup>8</sup> DaimlerChrysler, "Media Briefing Book": Competitive Labor Cost Comparison, p. 37,

[http://chryslerlabortalks07.com/Media\\_Briefing\\_Book.pdf](http://chryslerlabortalks07.com/Media_Briefing_Book.pdf).

<sup>9</sup> General Motors, "GM Manufacturing and Labor Resources Media Handbook: Pension Plan," p. 22,

[http://web.archive.org/web/20090126012238/http://www.media.gm.com/manufacturing/handbook/pensions\\_401k.pdf](http://web.archive.org/web/20090126012238/http://www.media.gm.com/manufacturing/handbook/pensions_401k.pdf). Note that the average age at retirement of a GM hourly employee is 56.

<sup>10</sup> Kaiser Family Foundation, "Medicare Chartbook, Fourth Edition, 2010," November 4, 2010, Figure 7.4, <http://facts.kff.org/chart.aspx?cb=58&sctn=168&ch=1788>.

<sup>11</sup> Sharon Terlep and Matthew Dolan, "Pension Trusts Strapped," *The Wall Street Journal*, November 7, 2011, <http://online.wsj.com/article/SB10001424052970203707504577011901934288534.html>.

<sup>12</sup> 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.

<sup>13</sup> Bankruptcy petition filed by General Motors Corporation in the U.S. Bankruptcy Court, Southern District of New York, June 1, 2009, [http://docs.motorsliquidationdocket.com/pdflib/01\\_50026.pdf](http://docs.motorsliquidationdocket.com/pdflib/01_50026.pdf). The \$20.6 billion excludes the assets in the GM "internal VEBA," which were also transferred to VEBA.

<sup>14</sup> Congressional Oversight Panel, "September Oversight Report," Figure 1. See also the testimony of Ron Bloom before the Congressional Oversight Panel, "Regarding the Treasury's Automotive Industry Financing Program, July 27, 2009. The \$8 billion excludes the approximately \$2 billion in assets in the Chrysler "internal VEBA," which were also transferred to the UAW VEBA.

By 2009, General Motors and Chrysler lacked the money to pay their creditors, including the UAW. The Obama Administration rightly required both automakers to file for bankruptcy as a condition of receiving further money from the government.

## **Violating Principles of Bankruptcy**

A cornerstone of bankruptcy policy is the requirement that creditors' priorities are preserved in bankruptcy in the same order as they are preserved outside bankruptcy, a concept known as the "absolute priority rule." The fundamental difference in priorities is between secured creditors on one hand and unsecured creditors on the other. Secured creditors, such as the bank that issues a mortgage or loans money to buy a car, have the right to seize the identified property if people fail to make payments. Unsecured creditors, such as credit card issuers, can sue individuals personally if they do not pay their bills, but cannot foreclose on someone's house unless mortgage holders are paid off first. Secured credit, therefore, is less risky than unsecured credit because it is a guarantee that the lender will be paid before unsecured creditors are paid. In exchange, debtors pay a lower interest rate to borrow on a secured loan (just as mortgage interest rates are much lower than credit card interest rates).

While most companies (including General Motors) are able to fund their operations through the issuance of unsecured bonds, Chrysler's bonds were secured, a testament to Chrysler's chronic financial struggles and the risk of lending to the company.<sup>15</sup> In bankruptcy, the secured status of these bonds should have meant that the secured creditors would be paid in full before any money was allocated to subordinate creditors, such as the UAW's VEBA plans. Instead, the plan imposed by the government forced Chrysler's secured creditors to accept only 29 cents on the dollar, while the UAW recovered most of the value of its claims.

Another bankruptcy principle was also violated in both cases. A fundamental principle of bankruptcy law is the presumption that similarly situated creditors should receive similar treatment in bankruptcy unless there is a compelling reason to do otherwise.<sup>16</sup> Thus, all unsecured creditors should be treated similarly regardless of whether their claims arise from bonds or unfunded pension liabilities. Yet, in both cases, the UAW's unsecured claims were treated much more generously than those of other unsecured creditors.

## **Preferential Treatment for the Union Trust Fund**

The UAW's claims had the same legal priority as those of other unsecured creditors. However, the union did substantially better in the bankruptcy. For their \$30.2 billion in claims, General Motor's unsecured creditors received 10 percent of the stock of New

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<sup>15</sup> Ford, beset by similar financial struggles, funded its turnaround through the issuance of secured debt as well, pledging as collateral, among other items, the famous blue "Ford" oval nameplate.

<sup>16</sup> 11 USC, §1123(a)(4) requires that a bankruptcy plan of reorganization "provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest."

GM, and warrants to purchase 15 percent more at preferred prices.<sup>17</sup> When they were distributed those shares and warrants were worth, in present value, \$8.7 billion.<sup>18</sup>

Had the Administration treated the UAW VEBA as it did other unsecured creditors, the VEBA would have recovered the same proportion of its debts. General Motors' \$20.6 billion obligation to the UAW would have been exchanged for 6.9 percent of the stock of New GM, and warrants to purchase 10.3 percent more at preferred prices. Those stocks and warrants would have been worth, in present value terms, \$5.9 billion.<sup>19</sup>

Instead, the United Auto Workers collected far more of its debts than the other unsecured creditors did. The VEBA received 17.5 percent ownership of New GM, \$6.5 billion of perpetual preferred stock paying a 9 percent dividend, and a note payable for \$2.5 billion (repaid early for \$2.8 billion).<sup>20</sup> The UAW sold a portion of its stake in New GM for \$3.4 billion in late 2010.<sup>21</sup> The UAW VEBA still owns about 10 percent of New GM. Its remaining stake is worth \$5.5 billion at current market prices. In present value terms, the UAW VEBA recovered a total of \$20.4 billion.<sup>22</sup>

If the UAW VEBA had been treated like GM's other unsecured creditors, the bailout would have cost taxpayers \$14.5 billion less. The union received highly preferential treatment.

The same thing happened at Chrysler. Chrysler's first-lien secured creditors collected \$2 billion on their \$6.9 billion in debt—just 29 cents on the dollar. Chrysler's second-lien secured creditors received nothing in bankruptcy for their \$2 billion in debt.<sup>23</sup> They were completely wiped out. Chrysler's unsecured trade creditors also recovered none of the \$5 billion they were owed.

Legally, the UAW's claims had lower priority than those of all secured creditors. The union should have recovered nothing on its claims until secured creditors—both first-lien and second-lien—were paid in full. Since the first-lien creditors were only partially paid

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<sup>17</sup> Motors Liquidation Company GUC [General Unsecured Creditors] Trust, "Form 8-K - GUC Trust Quarterly Section 6.2(C) and Budget Variance Report as of March 31, 2013." The series A warrants were intended to purchase 7.5 percent of GM at \$10 a share; the series B warrants were intended to purchase 7.5 percent of GM at \$18.33 a share.

<sup>18</sup> Heritage Foundation calculations from the "GUC Trust Quarterly Section 6.2(C) and Budget Variance Report as of March 31, 2013" See the appendix for the methodology. Note that this values the shares and options not yet distributed to unsecured creditors at GM's closing share price of \$34.64 on May 30, 2013.

<sup>19</sup> See the appendix for the methodology.

<sup>20</sup> U.S. Securities and Exchange Commission, "General Motors Corporation," Form 8-K, May 28, 2009, <http://www.sec.gov/Archives/edgar/data/40730/000119312509119940/d8k.htm>. The VEBA also received warrants to purchase additional shares of GM if the market capitalization of the company exceeds \$75 billion before December 15, 2031. That is roughly twice GM's current market capitalization. GM has the option of repurchasing the perpetual preferred stock for \$6.5 billion after December 31, 2014.

<sup>21</sup> Joann Muller, "UAW Cashes In on GM IPO; Pledges to Help GM Stay Viable," *Forbes*, November 18, 2011, <http://www.forbes.com/sites/joannmuller/2010/11/18/uaw-cashes-in-on-gm-ipo-pledges-to-help-gm-stay-viable/>.

<sup>22</sup> See the appended methodology for details of this calculation.

<sup>23</sup> Congressional Oversight Panel, "September Oversight Report," Figure 1.

and the second-lien creditors were wiped out, the UAW would have normally, along with the other unsecured creditors, recovered nothing. The Administration decided nonetheless to give the UAW trust a 55 percent ownership stake in New Chrysler (subsequently diluted to 41.5 percent), currently worth \$3.46 billion, and a note payable for \$4.6 billion earning 9 percent interest.<sup>24</sup> The UAW trust recovered most of the value of its claims.

If those assets had gone to the Treasury, the bailout would have cost taxpayers—in present value terms—\$9.7 billion less.<sup>25</sup> Instead, the Administration gave those assets to the UAW, despite bankruptcy law assigning their debts lower priority.

## Limited Concessions by Union Members

Section 1113 of the Bankruptcy Code gives bankruptcy courts explicit authority to force the rewriting of collectively bargained union contracts—like other contracts—in order to help the company become viable again. Just as bankruptcy courts reduce unworkable debts in order to rehabilitate a company, they also reduce unworkable union compensation and practices to competitive rates so that the company will be viable post-bankruptcy. In April 2012, for instance, the recently bankrupt American Airlines broke its union contracts after months of wrangling between management, and after the unions failed to produce a revised agreement. In other cases, the mere threat by a bankrupt company of breaking the union contract is sufficient to extract wage and benefit concessions from recalcitrant unions, as happened when Delta and United Airlines filed bankruptcy.

With GM, the UAW made some concessions during the 2009 bankruptcy. The union allowed GM to expand the use of entry-level “Tier 2” workers making half as much as regular workers.<sup>26</sup> This was a significant concession—by current employees on behalf of future employees.

The UAW also accepted limited concessions for existing “Tier 1” members. The union agreed to suspend their cost-of-living adjustments and performance bonuses. The union also agreed to reduce paid time off and place restrictions on overtime. The union further agreed to eliminate the JOBS bank that paid laid-off employees nearly full wages for not working.<sup>27</sup>

These changes reduced the automakers’ costs, but they retained most of the existing members’ compensation structure. As a result, GM’s post-bankruptcy compensation of \$56 an hour averaged across regular Tier 1 and entry-level Tier 2 employees is still

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<sup>24</sup> UAW Retiree Settlement Agreement between New Carco Acquisition, LLC, and International Union, United Automobile, Aerospace and Agricultural Implement Workers of America, April 2009.

<sup>25</sup> This does not necessarily mean that the union profited from the bailout. See the methodology for an explanation of these calculations.

<sup>26</sup> UAW General Motors, “Modifications to 2007 Agreement and Addendum to VEBA Agreement,” May 2009, at [http://www.uawlocal1853.org/wp-content/uploads/uawgm\\_may2009.pdf](http://www.uawlocal1853.org/wp-content/uploads/uawgm_may2009.pdf), and Center for Automotive Research (CAR), “2011 Detroit 3-UAW Labor Contract Negotiations,” November 29, 2011, <http://www.cargroup.org/?module=Publications&event=View&pubID=36>.

<sup>27</sup> UAW General Motors, “Modifications to 2007 Agreement and Addendum to VEBA Agreement.”

higher than all the transplants.<sup>28</sup> The Tier 1 workers' labor will still cost \$64 an hour at the end of the current contract.<sup>29</sup> As the UAW explained it to its members, "For our active members these tentative changes mean no loss in your base hourly pay, no reduction in your healthcare, and no reduction in pensions."<sup>30</sup>

Even President Obama's "car czar" Steven Rattner has admitted that the UAW should have made larger concessions on wages and that doing so would have substantially reduced the cost of the bailouts. Rattner stated: "We asked all the stakeholders to make very significant sacrifices. We should have asked the UAW to do a bit more. We did not ask any UAW member to take a cut in their pay."<sup>31</sup>

**Lost Savings.** In a normal bankruptcy, the pay and benefits of existing union members likely would have been reduced, probably to prevailing labor market rates. Only the taxpayer bailout allowed the UAW to avoid this. Moreover, one reason why the Senate rejected a bailout of the automakers in December 2008 was the UAW's refusal to reduce their compensation to market rates.<sup>32</sup> But once the decision was made to divert already appropriated TARP funds to the task—a use that Treasury Secretary Henry Paulson initially deemed to be beyond the scope of the legitimate use of the TARP funds—neither the Bush nor Obama Administrations pressed this point.

If the bankruptcy had lowered GM's average labor costs down to market rates, its costs would have fallen by \$800 million a year. Such concessions would have reduced operating costs and the size of the government's infusion of funds into the companies. They would have also raised profitability and thus the value of the government's stake in GM. These concessions would have saved taxpayers—in present value terms—approximately \$4.8 billion.<sup>33</sup>

**Unionized Delphi Retirees Treated Differently.** UAW members also received preferences at Delphi, the auto parts manufacturer and former GM subsidiary. 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 limit. When Delphi filed for bankruptcy the maximum pension benefits were \$54,000 a year for

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<sup>28</sup> Center for Automotive Research, "2011 Detroit 3-UAW Labor Contract Negotiations."

<sup>29</sup> Ibid.

<sup>30</sup> Ibid.

<sup>31</sup> Alex Nishimoto, "Rattner Says UAW Wages Should Have Been Cut During Bailouts," *Motor Trend*, December 16, 2011, <http://wot.motortrend.com/rattner-says-uaw-wages-should-have-been-cut-during-bailouts-147425.html#ixzz1saq52d2e>.

<sup>32</sup> These concessions reportedly were demanded primarily by southern Senators, such as Bob Corker (R-TN), as those states are home to numerous transplant factories, and they objected to bailing out Detroit's overpaid workers on the backs of their home-state constituents. See Josiah Ryan, "UAW Must Make Concessions in Exchange for Auto Bailout, Republican Says," CNSnews.com, December 12, 2008, <http://cnsnews.com/news/article/uaw-must-make-concessions-exchange-auto-bailout-republican-says>

<sup>33</sup> This is an approximation. Investors would probably view GM more favorably if the UAW made deeper concessions than it did, raising its price-earnings ratio above its historical rates.

retirees aged 65 and above, with lower benefits for early retirees.<sup>34</sup> About half of Delphi's union and non-union workers faced reductions in their pension benefits.<sup>35</sup>

New GM no longer had an obligation to supplement the Delphi pensions. The bankruptcy filing eliminated its contractual obligation to do so. 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 and the pensions of retirees belonging to two smaller unions. The non-union employees were not so fortunate—GM did not supplement their pensions.<sup>36</sup>

The TARP Inspector General is now investigating whether the Administration pressured GM to give the unions special treatment. The Inspector General “believes the Auto Task Force played a role in the pension decision,” but lacked the legal authority to force it to testify.<sup>37</sup> Former Administration officials—including “car czar” Ron Bloom, Rattner's successor—refused for over a year to cooperate with the investigation or answer questions until the House Oversight Committee threatened to subpoena them. Only then did the Administration officials agree to testify. Had New GM treated Delphi's union and non-union employees equally, the Treasury could have paid \$1 billion less for the bailout. Instead, some workers became more equal than others.

## **UAW Favored Over Other Unions**

The Obama Administration also favored the UAW over other unions during the bankruptcy proceedings. Approximately 2,500 employees at GM's Moraine, Ohio, assembly plant belonged to the International Union of Electrical Workers (IUE). They were among GM's most productive workers. When GM negotiated its 2007 contract with the UAW, it agreed to transfer work from Moraine to UAW facilities. The bankruptcy deal that the 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.<sup>38</sup>

## **Bailout Losses Entirely Due to UAW Subsidies**

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<sup>34</sup> U.S. Government Accountability Office, “Delphi Pension Plans: GM Agreements with Unions Give Rise to Unique Differences in Participant Benefits,” Report to Congressional Requesters, GAO-12-168, December 2011, Table 2, <http://www.gao.gov/assets/590/587045.pdf>.

<sup>35</sup> Ibid, Table 3.

<sup>36</sup> Ibid. The smaller unions were the United Steel Workers and the International Union of Electrical Workers. GM originally only topped-up the UAW pensions, but subsequently topped up the pensions of members of these unions as well.

<sup>37</sup> Letter from Christy Romero, Special Inspector General for TARP, to Representatives Darrell Issa, Michael Turner, and Elijah Cummings, Committee on Oversight and Government Reform, U.S. House of Representatives, May 9, 2012, at [http://turner.house.gov/uploadedfiles/5-9-12\\_to\\_mrt\\_-\\_sigtarp\\_letter\\_re\\_former\\_task\\_force\\_employees\\_refusing\\_to\\_testify.pdf](http://turner.house.gov/uploadedfiles/5-9-12_to_mrt_-_sigtarp_letter_re_former_task_force_employees_refusing_to_testify.pdf), and Jerry Zremski, “Officials Say They Deferred to GM on Pensions,” *The Buffalo News*, July 11, 2012 at <http://www.buffalonews.com/city/capital-connection/washington/article943280.ece>.

<sup>38</sup> Sharon Terlep, “UAW Freezes Rival Out of Rebound,” *The Wall Street Journal*, April 29, 2012, <http://online.wsj.com/article/SB10001424052702304177104577307184099140656.html>.

Adding all of this together—the disproportionate recovery of debts for the UAW trust funds, allowing the UAW to retain above-market pay, and subsidizing Delphi’s unionized pensions—shows the Administration redistributed \$30.0 billion more to the UAW than it would have received had it been treated as it usually would in bankruptcy proceedings.<sup>39</sup> Taxpayers lost between \$17 billion and \$20 billion on the auto programs.<sup>40</sup> Thus, the entire loss to the taxpayers from the auto bailout comes from the funds diverted to the UAW.

Had the government treated the UAW in the manner required by bankruptcy law, the taxpayers would have been able to recoup their entire investment in the company. The program would have amounted to subsidized loans instead of a direct bailout. The Administration could have kept the automakers running without losing a dime.

Accomplishing this would have been straightforward. At Chrysler, the Treasury—not the UAW—could have received the \$4.6 billion note and ownership of 41.5 percent of the company.<sup>41</sup> At General Motors, the bankruptcy process could have operated normally, reducing GM’s compensation to market levels and raising the value of the government’s shares. The Treasury could have also received the \$2.5 billion note, the \$6.5 billion in preferred stock, and the excess shares of GM given to the union. The Administration could have directed the firm not to treat Delphi’s UAW members better than non-union retirees and put less money into GM. Had the Administration done so American taxpayers would not have lost \$17 to \$20 billion.

Preferential treatment for the UAW was not necessary to keep GM or Chrysler in business. The UAW did not plan on organizing a strike in 2009. Even if it had, General Motors and Chrysler would have had no difficulty filling entry-level positions even though they paid less than transplant automakers.<sup>42</sup> The auto bailout was actually a UAW bailout.

## **The Staggering Size of the Bailout**

President Obama handed the United Auto Workers \$30.0 billion—more than the U.S. spent on all foreign aid programs in 2012 (\$20.0 billion). The union collected three-quarters more than NASA’s \$17.2 billion budget for 2012.<sup>43</sup> This was as much money as Congress appropriated at the start of the year to keep unemployment insurance benefits

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<sup>39</sup> These figures are in present value terms.

<sup>40</sup> These figures only include losses from taxpayer dollars spent by the government. They may underestimate the full impact of the bailout, as they exclude indirect taxpayer losses, such as the preferential tax treatment provided for Net Operating Losses and the “Cash for Clunkers” program.

<sup>41</sup> The Treasury actually received 6 percent of New Chrysler, which was subsequently sold to Fiat for \$500 million. Had the Treasury received the UAW’s share, the government’s stake in the company would have been 47.5 percent.

<sup>42</sup> The average cost to the Detroit automakers of entry-level workers is \$33.70 an hour. Center for Automotive Research, “2011 Detroit 3-UAW Labor Contract Negotiations.”

<sup>43</sup> U.S. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2012: Historical Tables*, Table 4.1: “Outlays by Agency, 1962–2017,” <http://www.whitehouse.gov/omb/budget/Historicals> (figures are for 2012).

extended at 73 weeks.<sup>44</sup> The UAW subsidies cost two and a half times as much as Congress spent last year on the Executive Office of the President, the legislative branch, and the judicial branch combined (\$12.1 billion);<sup>45</sup> more than the Department of Labor spent on job training programs (\$11.2 billion);<sup>46</sup> and almost as much as running the entire Department of Justice (\$31.2 billion).<sup>47</sup>

**Consequences for UAW Members.** This spending greatly benefited the UAW and its members. Without the Administration's favoritism, the union VEBAs would face a severe funding shortfall. This would force the union to increase the retirement age. UAW members would have had to wait until their 60s to collect retiree health benefits. The UAW would also have had to significantly reduce benefits for retirees enrolled in Medicare. The retiree health benefits would have become a modest supplement to Medicare.

Similarly, a smaller bailout would have required incumbent UAW members, not just new employees, to accept pay and benefit cuts. Average labor costs would have fallen to the same levels as the foreign transplants, approximately \$47 an hour. While this is still substantially higher compensation than the average manufacturing worker (\$33.52 an hour) it would still reduce UAW members' standard of living.<sup>48</sup> Such cuts would be painful but typical for firms reorganizing in bankruptcy. Moreover, while the UAW's members were spared much of the pain of bankruptcy, other workers were not so lucky—most notably those belonging to other unions and those enrolled in the Indiana State Police Pension Trust and the Indiana State Teachers' Retirement Fund, which held Chrysler's secured bonds that lost value through the politicized bankruptcy process.

**Consequences for Taxpayers.** These benefits for UAW members do not justify a \$30 billion taxpayer handout. No one should, of course, begrudge well-paid workers their success. When it is earned, high compensation is good. If UAW members can earn \$70 an hour through their productivity, they are entitled to the fruits of their labor. Those who succeed because of their own efforts have earned their high pay.

However, highly compensated workers should not be entitled to automatically continue to receive high pay. They must continue to earn it through their productivity. If their compensation contributes to their companies' bankruptcy they should not be allowed to maintain their living standards by taxing their fellow citizens.

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<sup>44</sup> Congressional Budget Office, "H.R. 8, American Taxpayer Relief Act of 2012," January 1, 2013. Note that the bill kept extended UI benefits through 2013, which allows some workers who begin collecting extended benefits in late 2013 to continue to collect them in 2014.

<sup>45</sup> U.S. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2012: Historical Tables*.

<sup>46</sup> U.S. Department of Labor, "FY 2013 Congressional Budget Justification: Employment and Training Administration," p. 23, <http://www.dol.gov/dol/budget/2013/PDF/CBJ-2013-V1-03.pdf> (accessed May 31, 2012). Figures are for FY 2012.

<sup>47</sup> U.S. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2011: Historical Tables*.

<sup>48</sup> Department of Labor, Bureau of Labor Statistics, "Employer Costs for Employee Compensation," Table 6, Q4 2012.

UAW members at General Motors and Chrysler are among the most highly paid workers in America. They received more than \$70 an hour in wages and benefits before the bankruptcy, and between \$52 and \$56 an hour now. The average American worker—whose taxes paid for the bailout—earns \$30.84 an hour in wages and benefits.<sup>49</sup> Few Americans have the ability to retire before they can collect Social Security. Fewer still receive retirement health coverage in addition to Medicare.

## **Conclusion**

The Obama Administration defends the cost of the auto bailout on economic grounds. The President argues that providing the money was necessary to prevent an economic catastrophe. But even if government intervention for the limited purpose of providing post-bankruptcy financing was deemed necessary due to the illiquidity of credit markets at the time, there was still no rationale for diverting tens of billions of taxpayer dollars (including taxes paid by the employees of the UAW's lower-paid competitors) to the UAW. The preferences given to the UAW account for the entire net cost of the bailout. The bailout would have cost \$30.0 billion less had the UAW been treated like GM's and Chrysler's other creditors. Instead, the Administration violated basic principles of bankruptcy law and transferred that money to the UAW—at taxpayer expense.

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<sup>49</sup> Ibid, Table 1.

## **Methodology - Appendix**

This testimony estimates the costs to taxpayers of the more favorable treatment given to the United Auto Workers (UAW) compared to similarly situated creditors in the auto bailout. It compares the amount that the UAW received to the amount it would have received given equal treatment, expressed in present values.

The current share price of GM stock was taken as its closing price on May 30, 2013, of \$34.64. A \$1 decrease/increase in GM's share price after this date will increase/decrease taxpayer losses by approximately \$240 million and will decrease/increase the UAW's recovery by approximately \$160 million.

### **Chrysler VEBA**

Chrysler's secured first-lien creditors collected only \$0.29 per dollar of debt that they were owed, and Chrysler's secured second-lien creditors and unsecured trade creditors collected nothing. Since the VEBA's \$8 billion in debt was unsecured, the union would normally have also collected nothing. Consequently, the cost of the bailout was assessed as the cost of the assets which the union VEBA received, and which could have gone to the Treasury Department instead.

For purposes of analysis it was assumed that the payout to senior creditors of Chrysler is invariant regardless of whether the subsequent return went to the government or the UAW. So, it was assumed that the payout from the Chrysler note and equity is the same under either scenario, but simply that it went to the government instead of the UAW.

The stock of New Chrysler is not currently publicly traded. The UAW and Fiat (which owns a majority stake of Chrysler) are currently engaged in litigation over the price Fiat must pay to buy out the union's shares. The courts have not yet resolved this issue. Instead the UAW's stake in Chrysler was valued using the \$8.33 billion market capitalization implied by the Treasury's sale of its 6 percent ownership of Chrysler to Fiat for \$500 million. That values the union's shares at \$3.46 billion.

The \$4.6 billion note was valued by bringing past payments into the present using the interest rate of a Treasury bill of that maturity to reflect the Treasury's cost of borrowing. For example, the \$315 million interest payment made on July 15, 2010, was brought forward using the interest rate of a three-year Treasury bill issued on July 15, 2010, of 0.98 percent.

Future payments were discounted using a higher interest rate to reflect the risk that they may not be paid. Throughout negotiations with the automakers, the UAW assumed a 9 percent discount rate on future obligations. To maintain comparability with the UAW's estimates, and to avoid differences resulting from separate choices of discount rates, future payments were discounted at 9 percent. Arguments can be made for a lower

discount rate. Choosing a lower rate would increase the present value of the assets—and thus the subsidy—given to the UAW.

The total value of the UAW's recovery is the sum of the value of the union's shares and the present value of the past and future payments on the note payable—\$9.7 billion.

Note that the UAW did not necessarily profit on the bailout at Chrysler. The \$8 billion reflects the estimated discounted present value of payments in April 2009 that GM was obligated to make to VEBA. The \$9.7 billion figure is expressed as a present value in 2013; and a different discount rate was used to bring past payments forward than that calculation did. As a result the calculations treat payments owed or made between 2009 and 2013 differently, and the figures are not directly comparable.

## **General Motors VEBA**

General Motors' unsecured creditors were owed \$30.2 billion and received 10 percent of New GM, warrants to purchase 7.5 percent of New GM at \$10 a share (series A warrants), and warrants to purchase another 7.5 percent at \$18.33 a share (series B warrants).

Data on the distribution of stocks and warrants to unsecured creditors were taken from the General Unsecured Creditors Trust.<sup>50</sup> The value of the stocks and warrants already distributed was assessed at the opening price of GM stock on the days they were distributed. The remaining undistributed 21.9 million shares and 39.8 million warrants for GM stock were valued at GM's current share price. Past payments were also brought into the future using the interest rate on Treasury securities to calculate the present value. The total present value of the shares and warrants distributed to unsecured creditors is \$8.7 billion.

At the time of the bankruptcy GM owed the UAW VEBA \$20.56 billion in unsecured payments. If these obligations received equal treatment with the other unsecured creditors the union would have received  $\$20.56 \text{ billion} \div \$30.2 \text{ billion} = 68.1$  percent of the equities given to the bondholders. This recovery would amount to 6.8 percent of New GM (102 million shares), series A warrants for 5.1 percent of the company (93 million warrants), and series B warrants to purchase another 5.1 percent (93 million warrants). Valued at GM's opening stock price on the days the shares and warrants were distributed to the unsecured creditors, these equities would be worth \$5.9 billion.

The UAW received 260 million common shares of New GM, \$6.5 billion in perpetual preferred stock paying a 9 percent dividend, and a note payable for \$2.5 billion that was repaid in October 2010 for \$2.8 billion. The UAW sold 100 million of these shares at the IPO for \$34 a share, raising \$3.4 billion, and retains 160,150,000 shares in its portfolio. The value of the note payable, the already paid dividend payments, and the shares sold in the IPO were expressed in present values using the appropriate short-term treasury bill

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<sup>50</sup> Motors Liquidation Company GUC [General Unsecured Creditors] Trust, "Form 8-K - GUC Trust Quarterly Section 6.2(C) and Budget Variance Report as of March 31, 2013."

rates on those dates. The value of the unsold shares of GM was calculated using the opening price of GM stock on May 30, 2013, of \$34.64 a share— \$5.5 billion. Future dividend payments and the repurchase of the \$6.5 billion in preferred stock on December 31, 2014, were discounted using the 9 percent discount rate. In total the UAW recovered assets with a present value of \$20.4 billion.

The difference between the value of the UAW's actual collection and the value of a proportional collection is the cost to the Treasury of the UAW preferences—\$14.5 billion.

Part of the UAW's greater recovery reflects the fact the union held onto their shares and GM's stock price went up. The unsecured creditors' shares and warrants were valued at GM's stock price the day they were issued. This difference in investment performances increased the value of the UAW's recovery relative to the unsecured creditors but does not reflect a politicization of the bankruptcy as such. An alternative assumption is that the unsecured creditors held onto their shares and warrants and enjoyed the same investment returns. Under this assumption the unsecured creditors' recovery would have been \$10.2 billion. A proportionate recovery for the UAW would thus be \$7.0 billion—68.1 percent of the unsecured creditors' recovery. Making this assumption reduces the value of the subsidy give to the UAW at GM by \$1.1 billion, and reduces the total union subsidy to \$28.9 billion.

## **Delphi Retirees**

The decision to supplement Delphi's unionized retirees' pensions cost GM an estimated \$1 billion as of December 2010. It was assumed that had GM not done so the Treasury would have reduced its investment in GM by \$1 billion (as of December 2010) with no loss in business performance. The \$1 billion was expressed in present value using the appropriate treasury bill rate.

## **Labor Costs**

Average hourly labor costs for UAW members remain above the rates paid by transplant automakers. It was assumed that, without special preferences for the UAW, the GM bankruptcy would have reduced hourly labor costs to the midpoint of the transplants—\$47 an hour. This \$9 an hour reduction in GM's labor costs, multiplied by 48,000 hourly employees working 35.5 hours a week for 52 weeks a year, would have reduced GM's labor costs by approximately \$800 million a year. These costs are approximations. GM plans to increase its workforce, which would increase the value of these concessions.

The value of these concessions to the Treasury Department was assessed by assuming this \$800 million a year was retained entirely as profits and that investors assigned the same price-earnings (P/E) ratio to GM as they did historically. These estimates should be taken as an approximation. It is likely that management would have invested a portion of these savings elsewhere. It is also likely that with lower labor costs and greater investments investors would value the company more highly than they currently do. This

would raise GM's P/E ratio. However, reliably quantifying how much GM's P/E ratio would hypothetically rise is not possible. GM's historical P/E ratio was used and all savings were treated as profits to avoid such speculation.

At the P/E ratio at which GM's shares sold in the IPO—approximately 12—an extra \$800 million in earnings would have increased GM's market capitalization by \$9.6 billion, and the value of the 28 percent of the company the Treasury Department sold, by \$2.7 billion. The Treasury sold 40 percent of its holdings in GM in December of 2012, and another 12 percent in April 2013. At that time GM traded at a P/E ratio of approximately 10. As of May 30, 2013, GM shares traded for a P/E ratio of just under 12. However, this represents GM's highest P/E ratio since its IPO. To avoid inflating the estimates by using overly optimistic P/E ratio projections this report assumes the Treasury's remaining shares as also sold at a P/E ratio of 10.

Under these assumptions, increasing earnings by \$800 million a year would raise GM's market capitalization by \$8.0 billion. This would raise the value of the shares the Treasury Department sold in December and April, as well as its remaining stake by \$2.1 billion. Forgone past payments were brought into the present using the appropriate short-term Treasury bill rate. In present value terms, maintaining UAW compensation above market rates thus cost taxpayers an estimated \$4.8 billion.

General Motors owes about \$20 billion in unfunded UAW pension obligations, one of the major factors depressing its share price. Bankrupt companies often discharge these obligations to the Pension Benefit Guarantee Corporation (PBGC). The PBGC guarantees pension benefits up to a maximum amount. Discharging the pension obligations would have reduced pension benefits for many UAW retirees while raising costs for the government and increasing the value of GM stock. The Administration directed GM not to discharge its pension obligations. It was assumed that if minimizing taxpayer losses had been an Administration priority it would have similarly directed General Motors not to transfer its pension obligations to the PBGC. This represents a departure from normal bankruptcy practice, which focuses on returning the company to viability, not minimizing taxpayer losses. Had GM discharged its pension obligations, the Treasury would have recovered a substantial portion—but not all—of the PBGC losses through the resulting appreciations of the government's shares in the company.

## **Discounting Values**

Because these events occurred over different periods of time, each transaction is discounted to the present time period to provide an accurate estimation of the current value of the preferential treatment. Transactions occurring in the past used the (then current) Treasury bill rate, for the appropriate length of time, to calculate the present value of this transaction. Following the assumptions made by the UAW, events occurring in the future use a 9 percent discount rate.

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As Heritage's Senior Policy Analyst in Labor Economics, James Sherk researches ways to promote competition and mobility in the workforce instead of erecting barriers preventing workers from getting ahead.

Sherk joined Heritage in 2006. His recent writings address ways to help unemployment insurance recipients return to work more quickly, why labor force participation has dropped during the recession, and the economic consequences of raising the minimum wage.

Sherk's work showed that federal employees make significantly more than comparable private-sector workers. This research attracted widespread national attention and contributed to the decision of President Obama and Congressional leaders to suspend scheduled across-the-board pay increases for federal workers.

Sherk's work on labor reform formed the basis for legislation allowing union members to earn pay increases above their union rate. Under current law unionized employers may not pay individuals above the union rate without the union's permission. The House of Representatives held a hearing on the Rewarding Achievement and Incentivizing Successful Employees (RAISE) Act, and the Senate voted on it.

Sherk frequently appears before committees of Congress to testify on labor policy issues. His commentary and analysis appear in such publications as the *Wall Street Journal*, *USA Today*, *The Washington Times*, *Business Week* and *Roll Call*. Such news networks as CNN, CNBC, Fox News and PBS have featured his commentary on pressing labor issues.

Sherk completed graduate studies at the University of Rochester, where he received a master of arts in economics with a concentration in econometrics and labor economics. He earned a bachelor's degree in economics and mathematics at Hillsdale College in Hillsdale, Mich.

Sherk, whose hobbies include hiking, reading and cooking, resides in Arlington, Virginia.

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Name:

James Sherk

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2. Please list any entity you are testifying on behalf of and briefly describe your relationship with these entities.

None. I am a senior policy analyst at the Heritage Foundation, but I am not testifying on behalf of Heritage at this hearing.

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I certify that the above information is true and correct.

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