Comment

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This provocative paper by Mark Ramseyer and Eric Rasmusen provides a useful overview of the restructuring of General Motors, and in particular highlights the political economy of the GM deal in which the U.S. Treasury wore two hats, being both an equity holder and a regulator. They focus on one of the main assets GM had on its balance sheets: its net operating losses (NOLs) valued at $45 billion. The reorganization of ''Old GM'' into ''New GM'' enabled New GM to retain the NOLs. Owning the NOLs increased the value of New GM and facilitated a restructuring deal that was favorable to the United Auto Workers (UAW) pension and health plans. However, as Ramseyer and Rasmusen argue, because of the 1986 Tax Reform Act, once the Treasury sells its holdings in New GM, the NOLs should be canceled and the value of New GM should decline dramatically.

The GM Bankruptcy

Ramseyer and Rasmusen do an excellent job describing the details of the GM case and the reader should refer to their article for the fine details. In my discussion I provide only a brief summary of the facts.

GM filed for bankruptcy under Chapter 11 of the Bankruptcy Code. Under this reorganization, Old GM was sold under Section 363 of the Bankruptcy Code to a new company, New GM. Typically when one company acquires another company's assets, it does not acquire its tax losses, but in this specific case New GM attained the NOLs of Old GM.

However, given that the Treasury plans to sell the shares it acquired in New GM, a problem may arise in the future: Under the

1986 Tax Reform Act, a corporation's ability to carry forward NOLs (and other tax credits) is limited when more than 50 percent of the stock changes hands over a three-year period (Ross, Westerfield, and Jaffe 2006). To solve this problem, the Treasury issued a series of notices declaring that Section 382 of the tax code does not apply to the Treasury. According to these notes, when the Treasury sells its shares in New GM, Section 382 will not be triggered even if more than 50 percent of ownership will change hands.

Ramseyer and Rasmusen's Critique

Ramseyer and Rasmusen make two points: First, Treasury had no *legal* justification to exempt GM NOLs from Section 382, hence the Treasury gave GM an illegal tax break. Second, the Treasury had no *economic* justification to exempt the NOLs from Section 382. In fact, Ramseyer and Rasmusen argue, there is a political economy explanation in which the exemption from Section 382 led to overvaluation of GM, which in turn made the government's position in GM look better and resulted in a transfer from the Treasury to other stakeholders—most notably the UAW, which held unsecured claims of $21 billion in GM.

The Economic Rationale

In my discussion, I will focus on the second point, according to which the Treasury had no economic justification to exempt GM's NOLs from Section 382. In order to assess the economic rationale behind the decision to exempt the NOLs from taxes, we need to evaluate the cost to the Treasury if the NOLs were not allowed to be carried forward to New GM. Ramseyer and Rasmusen argue that the UAW, as a junior creditor, got a very good deal in the restructuring of GM and that crafting such a deal was possible because of the ''overvaluation'' of GM stemming from the exemptions of the NOLs from Section 382. However, what would have been the cost to the Treasury if it failed to reach an agreement with the UAW?

Consider, for example, the case of GM retirees' medical benefits. As part of the restructuring, GM's Voluntary Employees' Beneficiary Association (VEBA) received from GM $2.5 billion of new notes, $6.5 billion in preferred stock with a 9 percent cash dividend, 17.5 percent of New GM common stock, as well as warrants for an additional 2.5 percent of the common stock of New GM. Ramseyer and Rasmusen argue that the Treasury actions led to a transfer to the UAW VEBA, which in turn is responsible for providing medical benefits to retirees.

Yet, had the restructuring of GM failed, VEBA's assets would have been depleted and it would have been unable to pay benefits in 2009.[1] As a result, it is likely that many more of GM's retirees would have had to rely on federal health insurance programs such as Medicare, imposing additional costs on the Treasury.

What about GM's pension plans? The restructuring agreements of GM provided that New GM take over the responsibility for the GM UAW pension plan. However, had the restructuring of GM failed, those pension liabilities would not have been assumed by New GM but would have rather been reneged. Moreover, had GM dumped its pension, it could have triggered other companies with underfunded pension plans to make a similar play. For example, other automakers could have tried to rid themselves of their defined benefit plans.[2]

The wrinkle is, however, that GM's UAW pensions are insured by the Pension Benefit Guaranty Corporation (PBGC), which is a U.S. government agency. Had GM's pension plans collapsed, the PBGC would have picked up a large part of the tab. As Brown (2008) argues, since the PBGC receives no tax revenues and given that it relies on premiums that are set by Congress, the PBGC's financial position has deteriorated, having in 2006 an $18.9 billion deficit. This is another example in which the Treasury could have ended up paying more had the restructuring of GM failed—and it is likely that GM would have failed to emerge from bankruptcy if its NOLs were not allowed to be carried forward.

SUMMARY

One can think about additional implications of a failure to restructure GM. Those include—but are not limited to—failures of autoparts makers, suppliers, further increases in unemployment, and other forms of local economic activity, resulting in even higher costs for the federal government.

[1] See ''A Message to UAW GM Retirees'' available at http://bankrupt.com/misc/gm_uawretireeletter.pdf.

[2] See, e.g., Benmelech, Bergman, and Enriquez (2011) for an analysis of pension dumping in the airline industry.

There is some rationale in having the Treasury structure a deal that leads to higher recovery by the UAW. An analysis of the transfer from Treasury to the UAW needs to take into account the different hats and pockets of the government. It is not clear that, on economic grounds, Treasury was not making the correct calculations.

REFERENCES

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