

Bailout: A Comparative Study in Law and Industrial Structure

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Economies are like bicycles: the faster they move, the better they maintain their balance. Changes in consumer preferences, technologies, international competition, and the availability of natural resources all require economies to reallocate capital and labor to newer and more profitable uses. Societies that redeploy their capital and labor more quickly and efficiently than others are apt to experience faster growth and greater improvements in productivity.

Redeployment is particularly difficult in regions that are dependent on a few large manufacturing firms. In such regions, a substantial portion of the plant, equipment, and labor force has been dedicated to making certain products. When markets for these products change radically, capital and labor are not always able to keep up. The investment required to redeploy these resources may involve too many workers and too much plant and equipment, entail too serious risks, and affect too large a portion of the regional economy to be undertaken without substantial sacrifice and dislocation. Failure to adapt, however, raises the specter of sudden liquidation, massive loss of jobs, erosion of the local tax base, and area-wide economic decline.

In some instances, the process that might normally be applied to effect the necessary redeployment—a bankruptcy under the protection of a court receiver or even an informal “workout” among creditors—is perceived to be inadequate. Although such a proceeding might entail concessions from employees, suppliers, and others with a direct stake in the company, it does not involve the participation of other “constituents”—manufacturers in the area, service businesses, communities dependent upon a healthy tax base—who have an indirect stake in a major firm’s continued operations. Inevitably, politics has interceded. Governments have been called upon to save jobs by “bailing out” the companies.

In recent years the U.S. government has responded with increasing fre-

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quency to calls for aid to certain large, distressed businesses. Conrail,¹ Lockheed,² Chrysler,³ and Continental-Illinois Bank⁴ are only the most visible "bailouts." Tariffs, quotas, and tax and regulatory relief are examples of additional efforts also directed at failing enterprises. These responses have released a storm of criticism and debate. Some people, recoiling from the ad hoc nature of these government actions, have called for a new government institution to aid troubled industries and companies.⁵ They typically point to Japan's Ministry of International Trade and Industry (MITI) as a model.⁶ Opponents of this approach typically point to the failures of Britain's National Enterprise Board or similar institutions.⁷

The debate to date has had a strange, disembodied quality, as if its participants were arguing over the best way to start up an old machine. There has been too little discussion of the social context in which economic change occurs—the vast network of rules, informal codes, shared understandings, and values which help determine how economies adapt. Broad policies cannot be borrowed wholesale from Japan or anywhere else. But smaller-scale rules and social understandings *can* be altered, if only incrementally. By understanding the detailed context of economic change, we can perhaps begin to face these more subtle possibilities.

The underlying question, then, is not that which many economists and policy analysts want to ask: "Are bailouts *good*?" It is a fact of social and political life that governments inevitably will respond to such calls for help. This essay, therefore, is not a search for normative judgments, so much as it is a quest for explanations and hypotheses. What accounts for the differences in how societies have responded to roughly similar problems? What are the underlying social realities? Perhaps most impor-

1. The U.S. Government's response to the problems of several failing northeastern and midwestern railroads is embodied in the Regional Rail Reorganization Act, 45 U.S.C. §§ 701-797 (1982). For a discussion of Conrail's return to profitability, see *Making More Hauling Less*, FORTUNE, Aug. 23, 1982, at 7.

2. The bailout of Lockheed Aircraft Corp. was effectuated through the Emergency Loan Guarantee Act, 15 U.S.C. §§ 1841-1852 (1982).

3. For a discussion of the bailout of the Chrysler Corp., see *infra* at 180-87.

4. For a discussion of the problems at the Continental Illinois Bank, see, e.g., Wall St. J., July 19, 1984, at 1, col. 6.

5. See, e.g., Eizenstat, *Reindustrialization Through Coordination or Chaos?*, 2 YALE J. ON REG. 39, 49 (1984); Weil, *U.S. Industrial Policy: A Process in Need of a Federal Industrial Coordination Board*, 14 LAW & POL'Y INT'L BUS. 981 (1983).

6. See C. JOHNSON, *MITI AND THE JAPANESE MIRACLE: THE GROWTH OF INDUSTRIAL POLICY, 1925-1975*, at 30-32, 305-24 (1982); Weil, *supra* note 5, at 994-97.

7. Many commentators have warned against the United States following the lead of Great Britain or other Western European countries in the industrial policy area. See, e.g., Krauss, "Europeanizing" the U.S. Economy: The Enduring Appeal of the Corporatist State, in THE INDUSTRIAL POLICY DEBATE 71-90 (C. Johnson ed. 1984) ("European experience shows that the real myth is the notion of an efficient industrial policy in the first place."); Miller, Walton, Kovacic & Rabkin, *Industrial Policy: Reindustrialization Through Competition or Coordinated Action?*, 2 YALE J. ON REG. 1, 23-27 (1984).

tantly, what can we learn through these comparisons about our own system of economic adaptation, and about its limitations and possibilities?

The article is organized into three parts. Part I examines in detail four large manufacturing companies—AEG-Telefunken, A.G., in West Germany; British Leyland in Great Britain; Toyo Kogyo in Japan; and Chrysler in the United States—and the “rescues” that were arranged to bail them out. Each of these major regional employers began to experience substantial losses at some time during the last decade, but for one reason or another did not make the investments required to shift their resources to potentially more profitable uses. Part II analyzes the responses to these four crises and identifies various underlying patterns in their politics, economics, and administration. In each case, the company dismissed employees, reduced capacity, and shifted some employees and assets to new, more productive uses after the bailout was initiated. However, the extent and pace of such shrinkage and shifting varied. Part III discusses possible explanations for these differences.

I. Cases

The four cases described in this section are not intended to be representations of how these political-economic systems typically redeploy people and capital within normal business reorganizations. To the contrary, the four cases are atypical; they depict systems under stress. These major business failures threatened, or were perceived to threaten, entire regions of the country and, to some extent, the entire national economy. Each case occurred during a particularly turbulent economic period. Each was perceived as exceptional and generated controversy, debate, complex negotiations, and a search for new solutions. Each case tested the system of normal political and economic arrangements among finance, labor, management, and government, and thereby illuminated the detailed rules and understandings that shape the relationships among these groups.

Typically, we see only the gross movements—the large deals, lawsuits, statutes, and economic aggregates—and mistake these for the social organization lying beneath them. It is only when the system is under stress, when the normal institutional relationships are stretched and tested, that we can see these underlying patterns more clearly, and understand what is unique about them and why their uniqueness matters.

The comparisons which are drawn in the following pages are not intended as a controlled experiment, in the sense that differences in how each of these large-firm crises was handled clearly indicate systemic differences among these four political-economic systems and their capacities to adapt to economic change. No such experiment is possible, because

there is an almost infinite number of variables which might have affected public and private approaches to these four cases and their eventual outcomes. Instead, the comparisons are intended merely to suggest systemic differences in the approaches and outcomes, and in social organization.

A. AEG-Telefunken, A.G.⁸

AEG-Telefunken, A.G., was founded in Berlin in 1883. After the Second World War, the company was dismembered because ninety percent of its production facilities were in East Germany. But the company capitalized on the consumer boom of the 1950's and 1960's, becoming a giant conglomerate. It bought up small companies that made washing machines, ranges, and household appliances. By 1970, it was the second-largest electronics manufacturing company in West Germany, after Siemens, and the fifth-largest in Western Europe. It also was responsible for approximately one percent of the nation's GNP.

In the mid-1970's, AEG's successes began to wane. Japanese manufacturers of consumer products started to invade the West German market, cutting into AEG's sales. The *deutschmark* rose relative to foreign currencies, making imports even more attractive and AEG's exports even less so. Moreover, having never fully digested its various acquisitions or imposed any coherent management structure upon them, the firm seemed incapable of cutting costs. The many acquisitions also had left the company deeply in debt. As costs rose, the company dipped into pension reserves, creating a large deficit in the pension fund.

The crisis came in 1979. Losses for that year mushroomed to \$580 million. In October, management presented to the company supervisory board a plan to reduce costs. The plan included elimination of 20,000 jobs, 13,000 to occur in 1980 alone. Labor representatives on the board strongly opposed the plan.

AEG's labor leaders met in Bonn with Count Lambsdorff, Minister of Economics in Helmut Schmidt's coalition government, and Hans Matthöfer, Minister of Finance. They argued that the government should invest in the firm, possibly taking over the company, and thereby saving jobs. Matthöfer, a union member and also a leading member of the Social Democratic party, was sympathetic, but concerned about the government's

8. This case study is based on data obtained from a wide variety of sources, including company reports of AEG-Telefunken, interviews, news accounts, and other materials. For the reader interested in learning more about this case one very useful source is D. Anderson, AEG-Telefunken, A.G. (July 1981) (Harvard Business School Case No. 1-381-187). For the purposes of this case and the cases which follow (see *infra* notes 16, 23, and 32), all foreign currencies have been converted into equivalent dollar values at the exchange rate applicable when the transaction discussed occurred.

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mounting deficits. Lambsdorff, a Free Democrat and economic conservative, opposed the plan. There was no agreement on a remedy for AEG's problems.

The Dresdner Bank, AEG's lead bank and the second largest bank in West Germany, then took the initiative. In December, Dr. Hans Friderichs, chief executive of Dresdner and a director of AEG's supervisory board, hosted a meeting of sixty-six of West Germany's most powerful business and financial leaders at the bank's headquarters in Frankfurt. Friderichs' message was clear: AEG needed financial help. If the help did not come from the banks, insurance companies, and other industrial giants there assembled, it would have to come from the government. If help came from the government, it would come with strings, and the strings would be tied to organized labor, giving it more power within management. One managing director of the Dresdner Bank put the matter bluntly: "Let's face it, either we are going to provide the subsidy or the State will, and if the State does then the State will want control . . . and there are certain voices in our political system that will be happy to ease the way."⁹

The assembled financiers and industrialists also were aware of mounting public concern about the powerful role banks played in the West German economy.¹⁰ The government was then considering legislation to limit the amount of equity any bank could hold in a given company. The bankers feared that an admission that they could not handle the crisis without state intervention would raise serious questions about why they should enjoy such sweeping power in corporate boardrooms.¹¹

The meeting produced a plan to aid AEG. Under the plan, a consortium of twenty-four banks would provide the company with the equivalent of \$376.2 million in new equity, bringing the banks' combined holdings to around sixty-five percent of the firm's outstanding shares. The banks also would reschedule about \$1.16 billion of the company's long-term debt and some \$700 million in short and medium-term debt. Insurance companies would subscribe to \$90 million in unsecured bonds at a rate one percent below that on long-term government bonds; other large industrial firms would subscribe to about \$125 million in similar bonds. In addition, shareholders would be asked to approve a two-thirds reduction in the nominal value of the company's stock. The company, in turn, would reduce its West German work force by ten percent in 1980, and would replace its chief executive with Heinz Dürr.

9. D. Anderson, *supra* note 8, at 15.

10. *See id.*, at 12-15. For a discussion of the role German banks traditionally play in the economy, *see infra* at 207-09.

11. Wall St. J., Nov. 26, 1979, at 16, col. 3.

The plan proved to be inadequate and losses continued to mount. In 1981, the firm lost \$260 million on sales of \$6.2 billion. Nearly the same results befell the firm in 1982. Accumulated debt rose to \$3.2 billion. Equity shrunk to ten percent of indebtedness. The 1981 recession, coupled with high interest rates, was partly to blame; the firm was still struggling to repay loans for its 1960's expansion.

Once again, the Dresdner Bank took the initiative. It sought to get the group of lenders to reschedule the existing debt and provide new loans. This time, however, the government's help would be needed. The company's debt was now too large, and its future too precarious, to rely any longer on a private-sector solution.

In the spring of 1982, Hans Friderichs and Heinz Dürr met with Count Lambsdorff and the new finance minister, Manfred Lahnstein. The recession had pushed unemployment up to more than seven percent from an average rate of 3.5% between 1977 and 1980. Prospective job losses were on everyone's mind. Friderichs and Dürr proposed that the government become involved in the company's plight. The banks would write off the firm's 1982 debt repayments of \$105 million, and would provide new loans up to \$800 million. But the government would have to guarantee to repay the loans if the firm went into bankruptcy. Labor leaders met separately with the government officials to ask for government assistance, but argued, as they had three years before, that in return the government should obtain an ownership interest in the company.

A few months later the government announced its decision. It would immediately provide AEG with loan guarantees equivalent to \$239 million for the purpose of financing export sales, on condition that the banks provide \$100 million in new loans. Additional loan guarantees would be made available to the company on the condition that an independent audit showed that the firm was still viable and could survive without aid in two or three years' time. Lambsdorff made it clear, however, that any solution to the company's problems was primarily the responsibility of the company and of West German industry, not of the state.¹²

AEG then dropped the other shoe. On August 9, 1982, after an emergency meeting of AEG's supervisory board, the firm announced that it had run out of cash, that its losses for the year could be as much as \$200 million, and that it would therefore seek reorganization under a court proceeding known as *Vergleich*, a type of partial bankruptcy under which sixty to sixty-five percent of a company's debt can be written off so long as the company's reorganization plan is approved by a majority of creditors

12. Wall St. J., July 15, 1982, at 34, col.1.

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holding among them at least seventy-five percent of the debt.¹³ If successful, the reorganization would wipe the company's slate clean of more than \$2 billion of debt. Reorganization would have the added advantage of eliminating \$520 million of unfunded pension liabilities, which would be taken over by the Pension Security Association, a semi-public corporation established in the early 1970's to insure the pensions of employees of insolvent companies. In addition to seeking reorganization, the company announced that 20,000 employees would be laid off.

The announcements shocked the West German financial community and labor unions. Labor leaders again called upon the government to buy the company in order to stop job losses. The government held firm, although Chancellor Helmut Schmidt's Social Democrats were about to face an important contest with the Christian Democrats in the State of Hesse, in which labor support was crucial. The conservative Free Democrats, on whom Schmidt depended to maintain his increasingly fragile coalition-government, opposed state intervention. The unions were philosophical. "The times have changed," stated Eugen Loderer, a chief of the labor union, IG Metall. "A cave-in has occurred that cannot be handled in the usual bombastic way. Union policy must accept the realities."¹⁴

Several weeks later the government formally agreed to guarantee up to \$440 million of new loans to the firm. The independent audit commissioned by the government had concluded that the firm had a good chance of survival so long as the court-supervised settlement of AEG's current debts was approved, the new loans were provided, and the company continued to slim down. Half of the loan guarantees would come from individual state governments, in proportion to their share of AEG's work force. In addition, certain states agreed to provide low-interest loans. For example, the State of Hesse would grant loans of up to \$400,000 at subsidized rates to any AEG supplier headquartered within the state.

AEG's creditors approved the reorganization plan. The banks then came up with more than \$800 million of new loans, half of which were guaranteed by the government. The crisis seemed to be over. Indeed, in 1983, AEG appeared to be back on a relatively even keel. Its stock price had rebounded to around \$47 a share, up from a low of around \$12 in 1979. Its worldwide payroll was down to 76,500 people—60,000 of them in West Germany. Although the company "celebrated" its hundredth birthday with losses of just under \$333 million for 1982, it cut its losses to

13. Vergleichsordnung §§ 7, 20, 73, 74, 1935 Reichsgesetzblatt [RGBl] I 321 (W. Ger.).

14. *Labor is Bracing for AEG's Collapse*, BUS. WK., Sept. 6, 1982, at 42, 43.

less than \$13 million in 1983, and it was expected to approach the break-even point in 1984.¹⁵

B. *British Leyland*¹⁶

British Leyland (BL) was created in 1968 when Harold Wilson's Labour government decided that the only way to preserve a strong British automobile industry that could compete worldwide was to merge the two remaining British-owned automobile companies, British Motor Company and Leyland Motor Company, into a larger-scale enterprise. The government, therefore, offered funds to induce the change.

The merger occurred on paper only. The two companies, which themselves resulted from more than thirty mergers over the years, remained fragmented. There were more than seventy plants scattered around England, many too small to achieve economies of scale. More than 200,000 employees were divided among eight divisions, seventeen different unions, and 246 bargaining units. In 1970, five million work-hours were lost to strikes and work stoppages; by 1972, the loss had reached ten million work-hours. Fierce inter-union rivalries also existed because many of the companies that had been merged into BL had been rivals for decades. According to one industry executive, "[t]he people at Longbridge [where Austins were made] wouldn't talk to the people at Cowley [the Morris plant], and the snobs at Jaguar wouldn't speak to any of them."¹⁷

Despite these problems, BL managed during the early 1970's to coast along on rising automobile sales generated largely by the government's decision to lift restrictive credit and tax measures. BL sold all the cars and commercial vehicles it could produce, though profit margins were extraordinarily low: in 1973, it sold 1.2 million cars, but earned the equivalent of \$66 million on \$3.8 billion of sales (a paltry 1.7%).

Then came the oil crisis and soaring inflation of the mid-1970's. BL's costs were so high relative to other auto companies and its quality so poor, that it could not compete. It began to lose money. The Austin 1300 sedan became one of the few cars ever to be awarded a "silver lemon" by the West German Automobile Club, a dubious honor bestowed for "horrible" mechanical faults. BL's share of the British market tumbled from forty-

15. German Trib., Jan. 8, 1984, at 7, col. 1.

16. The sources for this case study, as for the study of AEG, are too numerous to list comprehensively. See generally G. Lodge, *British Leyland: The Ryder Report* (Feb. 1982) (Harvard Business School Case No. 9-376-052); D. RYDER, R. CLARK, S. GILLEN, F. MCWHIRTER & C. URWIN, *BRITISH LEYLAND: THE NEXT DECADE* (1975) (abridged version of a report presented to the Secretary of State for Industry by a Team of Inquiry led by Sir Don Ryder) [hereinafter cited as RYDER REPORT]; *BRITISH LEYLAND, 1974 REPORT AND ACCOUNTS* (1975).

17. Wall St. J., Apr. 11, 1975, at 1, col. 6.

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five percent, just prior to the 1968 merger, to thirty-three percent in 1974; its share of the continental European market declined from ten to seven percent.

In July 1974, BL executives met with the firm's principal bankers—Barclays, Lloyds, Midland, and National Westminster—to ask them to lend the company the equivalent of \$1.2 billion for new investment over the next six years. The company already had borrowed \$315 million. The banks, however, were unwilling to extend any more loans. By September, BL's cash position was deteriorating quickly. Losses for the fiscal year amounted to \$46.2 million. With its share capital valued at only \$360 million, the company had a worrisome debt-to-equity ratio of approximately one-to-one.

The crisis was deepening. In a few months, BL would not be able to pay its bills. BL executives and their bankers met in late November with Tony Benn, Secretary of State for Industry in the Wilson government. On December 6, 1974, Benn announced that the government would seek Parliament's approval for public aid to the company, perhaps including some degree of public ownership. He immediately appointed a team of business and labor leaders, under the direction of Sir Don Ryder, a noted industrialist, to assess both BL's present situation and its future prospects, and report back to Parliament.

The *Ryder Report*,¹⁸ issued on March 26, 1975, blamed BL's troubles on inadequate capital investment, poor labor-management relations, and inefficiently organized production. According to the report, however, the situation was not hopeless: the company could become profitable again with an infusion over the next seven years of the equivalent of \$6.2 billion for new investment. Half of this money would come from the government; the other half would be generated internally. Through its purchase of old and new shares, the government would own a majority of the company. In addition, the report proposed the establishment of a new structure of "industrial democracy" within the company, in order to take advantage of the ideas and enthusiasm of the work force and overcome hostilities. It also suggested reorganizing the company into four separate profit centers with responsibility, respectively, for cars, trucks and buses, international sales, and other special products.

On April 24, 1975, Prime Minister Harold Wilson, the leader of the Labour Party, described the government's plan to rescue BL to a packed and somber House of Commons. Wilson explained that the company's importance to the national economy necessitated such a vast investment.¹⁹

18. RYDER REPORT, *supra* note 16.

19. N.Y. Times, Apr. 25, 1975, at 45, col. 1. See also RYDER REPORT, *supra* note 16, at 3

After a bitter and acrimonious debate, Parliament agreed.²⁰ BL announced in a letter to its shareholders that it had accepted the plan. The company's managing director resigned and was replaced with a new chief executive. BL's aged chairman, Lord Stokes, was given the figurehead position of president, and a new chairman was installed.

The government immediately provided BL with the equivalent of \$426 million of new equity capital; the rest would come in stages, as BL met certain performance benchmarks. The National Enterprise Board (NEB), a semi-independent government agency, then headed by Sir Don Ryder, would provide these funds. The Board soon began working with BL's new management, restructuring the company along the lines that had been suggested in the *Ryder Report*.

Labor disputes increased as a result of these efforts. Ryder's plan for industrial democracy involved a complex hierarchy of plant committees, divisional committees, and senior councils. Shop stewards, who had the greatest power under the old arrangement, feared that the new system would create a rival channel of communication. A compromise was reached which gave the shop stewards responsibility for putting forth a slate of worker delegates to the committees and councils.

There were other problems. Middle managers felt excluded from the process, while senior managers had all they could do to attend the 760 weekly meetings of the various groups: Confidential company information leaked out to the press. Rank-and-file workers continued to engage in wildcat strikes. There were stoppages at the Triumph works over track speed, at Bathgate over pay, at Coventry's Jaguar plant over a management decision to install a new paint shop at Castle Bromwich—which the workers feared would jeopardize the independence of Jaguar. Moreover, workers continued to complain about salaries and responsibilities, as well as about other company policies.

Productivity in 1977 was lower than in the crisis year of 1974. The company estimated that strikes and work stoppages reduced production by 225,000 vehicles. Losses amounted to the equivalent of \$110.5 million. The company sold 785,000 vehicles (down from 1.2 million in 1973), and BL's share of the British automobile market slipped to twenty-three percent (from thirty-three percent at the time of the *Ryder Report*). The National Enterprise Board continued to hand out money, but the government threatened to review and revise the entire Ryder plan.

("[V]ehicle production is the kind of industry which ought to remain an essential part of the UK's economic base. We believe, therefore, that BL should remain a major vehicle producer, although this means that urgent action must be taken to remedy the weaknesses which at present prevent it from competing effectively in world markets.")

20. 892 PARL. DEB., H.C. (5th ser.) 1542 (1975). See also *infra* note 64.

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A turning point of sorts came in the fall of 1977, when Leslie Murphy took over from Don Ryder at the NEB. Among Murphy's first acts was to dismiss BL's chief executive and its chairman. The NEB appointed Michael Edwardes to both positions. As chief executive of Chloride Group, Britain's largest battery maker, Edwardes had earned something of a "whiz kid" reputation; he had also been one of the first members of the NEB.

Edwardes immediately set out to reduce BL to profitable size. He revised the firm's production targets downward to 800,000 vehicles and twenty-five percent of the British market, and announced the need for a corresponding cut in employment. He offered workers bonuses of up to \$3000 if they would leave the company voluntarily. Simultaneously, Edwardes took a tough line with the unions. He closed the Speke plant in Liverpool, which had been plagued by work stoppages and poor workmanship, thereby laying off 3000 workers. When the machinists at Scotland's Bathgate truck and tractor factory went out on strike, Edwardes announced a \$70 million cut in planned investment at the plant.

By late 1979, as Margaret Thatcher moved into Downing Street and the Conservatives took over the reigns of government, BL's share of the British auto market had fallen for the first time to under twenty percent. Only 625,000 vehicles were manufactured, down from 785,000 in 1977, and 1.2 million in 1973. The company had slimmed: it now employed 165,000 people (down from 211,000 in 1975). With under two percent of the world's automobile market, BL was the smallest full-range automobile manufacturer on the globe. Losses for the fiscal year ending in September were the equivalent of \$242 million, double the losses for 1977 and almost four times the losses for the crisis year of 1974. All told, the Labour government had invested more than \$1 billion and lent the company more than \$500 million.²¹

It was now the Tories' turn to deal with BL's problems. Union leaders met with Keith Joseph, the new Secretary of State for Industry, and argued for more government assistance. Joseph opposed generous concessions to BL. Edwardes announced that substantial new public investment was needed both to launch new models and to encourage voluntary layoffs. He warned that, without the funds, BL would be forced into bankruptcy and he would resign. He also unveiled a plan to scale back BL still further by closing thirteen more plants and cutting an additional 25,000

21. The poor performance could no longer be blamed entirely on the company. Sales of North Sea oil had strengthened the pound, thereby making all British exports less attractive. At the same time, higher oil prices dampened demand for larger cars, on which BL made its highest profits.

workers from the payroll. Joseph relented. The Conservatives agreed to provide the equivalent of an additional \$660 million in cash.

However, this new infusion of capital did not help. Although 1979 had been a bad year for BL, 1980 was even worse. Losses were \$1.2 billion on sales of \$6.5 billion. The world auto industry was generally in a slump. BL had invested a substantial portion of the government's money in developing new models, but they were still months away from appearing in showrooms. In the meantime, new cash was needed desperately. After a stormy meeting of the Cabinet in February 1981, Joseph announced that the government would provide BL with another cash infusion—this one the equivalent of \$1.2 billion. One ministerial colleague commented dryly: "There's a job waiting for Sir Keith Joseph in Oxford Street. He's been practicing the role of Father Christmas."²²

The rest of the story is more upbeat. Losses for 1981 were slightly less than the year before. By 1982, losses had been reduced to \$275 million and in 1983 the company nearly broke even. Certain divisions, like Land Rover and Jaguar, actually turned a profit. The new models were enormously successful. The Metro became Britain's most popular compact. The Maestro, a 5-door hatchback, was introduced to much acclaim in early 1983. News reports featured Mrs. Thatcher at the wheel, proudly motoring up and down Downing Street for the cameras. BL's share of the British market bounced back almost to twenty percent. Productivity was up and the company was now considerably leaner. Capacity had been reduced to roughly a half-million vehicles; employment was down to 100,000. Industry observers predicted a rosy future.

C. *Toyo Kogyo*²³

Toyo Kogyo, founded in 1920 in Hiroshima, began as a manufacturer of cork products. The company's first automobile, introduced in 1931, was little more than a wagon attached to a motorcycle. During the Second World War the company produced rifles, rock drills, and gauges to measure the accuracy of precision-engineering instruments. When the United States dropped the atomic bomb on Hiroshima on August 6, 1945, Toyo Kogyo's factory and its 10,000 workers were shielded by a small hill separating them from the rest of the city.

Tsunjei Matsuda, son of the company's founder, took over as president

22. *BL: It's the Thought that Counts*, *ECONOMIST*, Jan. 31, 1981, at 48.

23. This case study is based on data obtained from a wide variety of sources including company reports of Toyo Kogyo, interviews, news accounts, and other materials. See, e.g., *The Turnaround at Mazda—Is there a lesson for Chrysler?*, *L.A. Times*, Oct. 25, 1981, § 5, at 1, col. 5; TOYO KOGYO, SUMMARY OF TOYO KOGYO (1983).

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in 1951. The company became one of Japan's leading truck makers under the brand name "Mazda," a contraction of Matsuda. Matsuda was intent on using Toyo Kogyo's expertise in engineering to compete with the much-larger Toyota and Nissan automobile companies. In 1960, the firm produced its first "real" car, a tiny sixteen horsepower two-seater.

Soon thereafter Toyo Kogyo turned for help to the Sumitomo Bank, one of Japan's largest banks. Until that time Toyo Kogyo's lead bank had been the Hiroshima Bank, but the firm was now sufficiently large that it needed the backing of a larger financial institution. The new relationship proved auspicious. Shozo Hotta, the chairman of Sumitomo Bank, introduced Matsuda to West Germany's Konrad Adenauer, and Adenauer in turn arranged for Toyo Kogyo to obtain from Audi-Wankel a license to produce a rotary engine which Audi engineers had just designed.

By 1967, Toyo Kogyo was the world's only commercial manufacturer of cars equipped with rotary engines. The cars were wildly successful: rotary engines produced relatively little pollution (an important advantage, as the Japanese government progressively tightened pollution-control standards in the 1970's), were snappy and responsive, and were novel.

Before introducing rotary engine models, Toyo Kogyo produced about 150,000 cars and trucks a year; after it began to concentrate on rotary engines, production increased dramatically. By 1973, Toyo Kogyo was building 740,000 vehicles annually and had become Japan's third largest automaker. Its export sales, mostly to the United States, were booming. It was expanding its facilities to accommodate annual production of one million vehicles. Its workforce also expanded rapidly, reaching 37,000 by 1973—4.5% of the working population of Hiroshima prefecture. If component suppliers are included in the calculation, 7.4% of total jobs in the prefecture derived from Toyo Kogyo, one-quarter of the total manufacturing employment. Hiroshima's other major industry, shipbuilding, was in steep decline, so that the regional economy was growing even more dependent on Toyo Kogyo.

Toyo Kogyo's success was abruptly shattered by the oil crisis of the mid-1970's. With all their advantages, rotary engines had one telling disadvantage: they were inefficient. According to a 1974 report of the U.S. Environmental Protection Agency, Mazdas with rotary engines got only ten miles per gallon in city driving.²⁴ Rapidly rising oil prices therefore meant rapidly falling sales. In 1974, U.S. sales of Mazdas declined by more than 43,000 cars, and Japanese sales also plummeted. Inventories bulged.

24. U.S. ENVIRONMENTAL PROTECTION AGENCY, 1974 GAS MILEAGE GUIDE FOR CAR BUYERS: FUEL ECONOMY TEST RESULTS FOR AUTOMOBILES AND LIGHT-DUTY TRUCKS 4-5 (1974).

Nevertheless, throughout 1974 Kohei Matsuda, the president of the firm and grandson of the founder, continued to make rosy projections. Late in the year he called a press conference to announce that a new rotary engine with forty percent better fuel efficiency would be in production before the end of 1975. (In fact, it took Toyo Kogyo engineers six more years to achieve this feat.) Despite declining sales, Matsuda refused to cut production, with the result that by the end of 1974 the company was left with 126,000 unsold cars. Not surprisingly, the company's performance in 1974 was a disaster; it lost the equivalent of more than \$75 million on \$2 billion of sales. The firm had sunk even more deeply into debt than normal for debt-laden Japanese firms. By the end of 1974, the firm's bank indebtedness had grown to \$1.5 billion, and its debt-equity ratio had mushroomed to four-to-one.

Sumitomo Bank officials were not standing idly by. They suggested to Kohei Matsuda that the firm cut production and stop its expansion program, but Matsuda would not listen. Meanwhile, Toyo Kogyo dealers from around Japan expressed their concerns about the company to bank officials. The dealers' lack of confidence, coupled with Matsuda's intransigence and the rapidly deteriorating position of the firm, forced the bank's hand.

In October 1974, the bank sent two of its senior officers to Toyo Kogyo to join the firm's management temporarily. This action was intended to "strengthen the company's financing operations [and] prepare for a possible deterioration in the company's business."²⁵ The Sumitomo officers took charge of the biggest trouble spots: financing the ballooning inventories of unsold Mazdas in the United States, and projecting the firm's performance over the next year or two. These emissaries were followed by others. In all, over the next two years, Sumitomo Bank and Sumitomo Trust Company placed eleven of their top-level executives in key positions within Toyo Kogyo. These included Tsutomu Murai, managing director of the bank, who took over as executive vice president of the automaker. Murai described the changeover bluntly: "For now, we're an army of occupation. Active intervention is unavoidable."²⁶

The Sumitomo rescue team acted quickly. Kohei Matsuda, Toyo Kogyo's president, was made chairman of the company without any operating duties. Two-thirds of the company's section chiefs were shifted to new positions. Costs were slashed in all areas. Production was cut back, expansion plans were dropped, \$54 million in stock and real estate was sold off, dividends were reduced by twenty percent for three years, hiring

25. *Wall St. J.*, Oct. 3, 1974, at 11, col. 1.

26. *Where is Toyo Kogyo Going?*, TOYO KEIZAI [ORIENTAL ECONOMIST], Feb. 14, 1976.

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of new assembly workers was halted for four years, pay levels were frozen for all managers at the rank of section chief or above (about four percent of the total payroll), directors' salaries were cut and bonuses ended for three years, and the union accepted pay raises lower than those received by auto workers at other automobile companies.

One major cost remained. With production cut, the company no longer needed one-quarter of its workforce. Ten thousand employees were now redundant. Rather than lay off the workers, the new Toyo Kogyo managers devised a scheme for training them as auto salesmen and sending them to Mazda dealers around Japan to sell the excess cars door-to-door. About 5000 employees, mostly from the shop floor, took part in the plan between 1975 and 1980. The other 5000 employees gradually retired from the firm over the five years. Each participating employee spent two years in sales work before returning to his factory job. Most were assigned to Tokyo and Osaka, hundreds of miles north of Hiroshima. The company paid each participant his incidental expenses, provided a supplemental wage in order to match his factory salary, and housed him in company-owned dormitories.

Mazda dealers were delighted to have the extra help. It is common in Japan to sell automobiles door-to-door, and a larger sales force means more sales. The displaced workers, however, were less enthusiastic. The two-year shift often meant absence from family and friends. Many found the transition from production to sales to be difficult. Hayato Ichihara, who later became president of the company's union, explained why workers went along: "[W]e feared that if we didn't accept the proposal the company would demand we accept dismissals of workers in exchange for wage increases. And union members did understand that there were too many workers for the work that existed."²⁷

Simultaneously with their cost-cutting efforts, Toyo Kogyo's new managers shifted the firm's competitive strategy. Rather than compete solely on the basis of engineering, the company henceforth would compete on the strength of its sales organization and its low costs. But the new managers also knew that Toyo Kogyo's future would depend on new models. The company continued to hire engineers and pour money into developing cars both with conventional piston engines and with rotaries. Between 1977 and 1980 Toyo Kogyo introduced five new models, including a fuel-efficient rotary.

Sumitomo Bank financed much of this transition and arranged financing for the rest. By 1976, when Toyo Kogyo's accumulated debt reached the equivalent of \$1.6 billion, the bank's share reached \$256 million, six-

27. *Hard Times Make Tenjin a Top Auto Salesman*, L.A. Times, Oct. 25, 1981, § 5, at 1. col. 3.

teen percent of the total. The following year it boosted its lending by \$70.9 million, to a peak of \$327 million. When the other sixty banks and insurance companies which had lent money to Toyo Kogyo threatened to cut off future credit, Ichiro Isoda (later president of Sumitomo Bank and then an executive in charge of the Toyo Kogyo account) called the other lenders to a meeting at Sumitomo's headquarters in Osaka and assured them that regardless of what happened to Toyo Kogyo in the future, the Sumitomo Bank would "stand by the company to the end" and would be making additional loans in the near future.²⁸ Isoda then asked the other lenders not to desert Toyo Kogyo either, and promised them that all creditors would share equally in repayment of any new loans. In the end, only a few of the lenders came forth with additional loans, but none called in the loans then outstanding.

Sumitomo Bank also twisted arms. Members of the Sumitomo *keiretsu*²⁹ provided additional loans. They bought most of the \$54 million in stocks and real estate which Toyo Kogyo was forced to sell. They also purchased large numbers of Mazdas from Toyo Kogyo's bloated inventories. Sumitomo Bank branch offices around Japan steered bank customers to Mazda dealers. The bank also provided a large loan to C. Itoh, a major trading company which was not a member of the *keiretsu*, on condition that Itoh take over Toyo Kogyo's sales organization in the eastern United States and purchase its inventory of 10,000 unsold cars. Finally, in 1979 the bank arranged for Ford Motor Company to purchase twenty-five percent of the outstanding shares of Toyo Kogyo, a move which dramatically improved Toyo Kogyo's cash position.

Additional help came from the city of Hiroshima. Business leaders formed an association called a *Kyoshinkai* ("Home Heart Group") to promote Toyo Kogyo sales in the region. The prefectural government cooperated by enacting a new and far stricter pollution-control law. Because rotary engines produced less pollution than conventional engines, this

28. Interview with Satoshi Yamada, General Manager of Sumitomo Bank, in Osaka, Japan (Sept. 16, 1983) [hereinafter cited as Yamada Interview].

29. *Keiretsu*, groups of companies united by stock ownership and financial support, are the post-war descendants of the great *zaibatsu*, whose hand in the Japanese war effort led to their dissolution during the American occupation after World War II. The four most famous pre-war *zaibatsu*—Mitsubishi, Mitsui, Sumitomo, and Yasuda—included firms in every sector of the economy from heavy industry to banks, each bearing the *zaibatsu's* name and all centered around a single holding company exercising strict control. Unlike the *zaibatsu*, the *keiretsu* is centered around a large bank which exercises considerable influence over the *keiretsu's* members. The power of this lead bank is assured not only by its debt and equity arrangements with the firms in the *keiretsu*, but also by the interlocking financial and operating linkages among the firms and by the efforts of the group's trading company. See R. CAVES & M. UEKUSA, *INDUSTRIAL ORGANIZATION IN JAPAN* 62-68 (1976); see also K. HAITANI, *THE JAPANESE ECONOMIC SYSTEM* 120-25 (1976). The main role of the lead bank within a *keiretsu* is to guarantee a member's debt and thereby permit heavy leveraging of investment. C. JOHNSON, *supra* note 6, at 206.

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change had the effect of reducing the pollution tax on rotary-engine vehicles relative to the tax on conventional engine models. These efforts served to raise Toyo Kogyo's share of the regional market from twenty to thirty-five percent, and further reduced inventories.

The national government did not intervene directly, but its presence was felt. From the beginning Sumitomo Bank officials understood that the Ministry of Finance was vitally concerned about the future of the company and that the central bank would make every effort to cooperate. The Ministry of International Trade and Industry (MITI) at first considered merging Toyo Kogyo with Mitsubishi or Honda. However, in a widely circulated speech Tomatsu Yoguro, vice-minister of MITI, announced that MITI would not look favorably upon a merger. MITI also encouraged Toyo Kogyo's large suppliers, such as Mitsubishi Steel, to continue their dealings on normal terms. The Ministry of Finance encouraged major banking institutions, like the Industrial Bank of Japan and the Long-term Credit Bank, to provide Toyo Kogyo with additional credit. In 1979, MITI obligingly cleared away legal hurdles for Ford's purchase of one-quarter of Toyo Kogyo.

Toyo Kogyo's new models were successful and, because they could all be produced on the same production line at the same time, the company had the flexibility to vary its output while fully utilizing its plant and equipment. This new organization of production fueled productivity improvements, from nineteen cars a year per worker in 1973 to forty-three cars in 1980.

By 1980 the company was profitable once again. Its debt had been reduced to the equivalent of \$943.5 million, and the infusion of new equity from Ford had reduced its debt-to-equity ratio to under two-to-one. It sold more than one million vehicles, slipping past Chrysler to become the world's ninth-largest auto maker.

Successes continued. Export sales ballooned. Ford began to rely on Toyo Kogyo's supply of subcompacts and components. In 1983, its most popular export model, the Mazda 626, was named United States "Import Car of the Year" by *Motor Trend* magazine.³⁰ That year the company sold 1.2 million vehicles, earning the equivalent of \$91.4 million on \$4.3 billion of sales. In the fall of 1983, looking back on nine years of rebuilding the company, Satoshi Yamada, general manager of Sumitomo Bank's credit department and one of the bank executives who had spent time at Toyo Kogyo, said: "[I]t was a difficult period. Many people sacrificed. We didn't know how it would come out in the end. We are very pleased."³¹

30. MOTOR TREND, Apr. 1983, at 9.

31. Yamada Interview, *supra* note 28.

D. *Chrysler*³²

The Chrysler story began in 1922 when several bankers, worried about their outstanding loans to the faltering Maxwell Motor Company, persuaded Walter P. Chrysler to take over management of the auto company. The company had expanded too rapidly and haphazardly during the First World War and the short boom following it. It had been unprepared for intense competition from other upstart automakers and a decline in demand when the market returned to normal. Chrysler persuaded the bankers to extend new loans to Maxwell and forgive much of the old debt in exchange for stock and stock options. He also raised more funds by hurriedly redesigning Maxwell's old line of cars and slashing the price. In 1924, he unveiled a new car with a high-compression engine capable of extraordinarily quick starts. More than 32,000 Chryslers were sold that year at a profit of over \$4 million, and the name of the company was changed to the Chrysler Corporation. The company continued to flourish, purchasing Dodge in 1928. It weathered the Depression better than most businesses.

Chrysler's performance after the Second World War was less impressive. Walter Chrysler was gone. The company was slow to ready new models to meet the postwar boom; its historic strength lay in engineering rather than in marketing and styling, which were now the keys to capturing Americans' growing demand for autos. It gained twenty-two percent of the U.S. automobile market in 1951, but then entered a long downward trend that would take its share below ten percent in 1962. It bounced back a bit in the mid-1960's under the direction of Lynn Townsend, who emphasized design and sales. Townsend also launched the firm on an ambitious expansion program which drained the firm of cash and made it vulnerable to sudden changes in demand.

Chrysler's first brush with bankruptcy came in 1970, when it lost \$27 million in the first quarter and plunged deeply into debt. The Penn Central bankruptcy that year made investors wary of any company with heavy debt and current losses. A rescue mission was mounted by John McGillicuddy, then a vice-chairman of Manufacturers Hanover Trust Co., Chrysler's lead bank. He organized a syndicate of banks to pump \$180 million into Chrysler's critical financial subsidiary, which in turn continued to provide loans to car buyers. The firm got a second wind.

However, the oil shock and the 1974 recession caused auto sales to plummet. Chrysler went into a tailspin. Lynn Townsend was replaced by

32. The data on which this case is based were obtained from company reports, interviews and news accounts. A much more detailed version of this study appears in R. REICH & J. DONAHUE, *NEW DEALS: THE CHRYSLER REVIVAL AND THE AMERICAN SYSTEM* (1985).

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John Riccardo, whose strategy was basically to keep the company solvent by selling off the foreign subsidiaries that Townsend had created and closing marginal factories around the United States. Eventually, even these cuts proved to be insufficient. In 1978, the firm lost \$204.6 million on under \$13 billion in sales.

By the summer of 1979, Chrysler's lenders had become extremely worried. The firm by now owed more than \$1 billion to almost 400 separate financial institutions spread around the globe. Chrysler needed more loans, but its creditors were in no mood to accommodate. McGillicuddy, now chairman of Manufacturers Hanover, persuaded Chrysler to host a meeting of its major creditors to allay their fears. The meeting was held at Chrysler's headquarters; one participant described it as little more than a pep rally, in which no new information was forthcoming but Chrysler executives expressed determination and confidence.³³ The bankers agreed to keep available to Chrysler \$750 million in short term credit, but warned that they could not arrange additional funding. Their fears and warnings mounted in July after Riccardo announced Chrysler's performance for the second quarter: the company had suffered a loss of \$207 million on sales of \$3 billion. This loss was worse than the total losses for 1978.

Politicians also were becoming worried. Chrysler had closed a number of plants in 1978 and more closings seemed imminent. The firm directly employed 140,000 people, and hundreds of thousands more worked for suppliers. Most of the workers were concentrated around the Great Lakes. Riccardo hoped that the new Democratic administration would be sympathetic to Chrysler's problems and the hardships that would result from massive layoffs. Since President Carter's election, Riccardo had made repeated trips to Washington, seeking financial assistance to modernize certain plants and relief from fuel efficiency and environmental regulations. At first, his requests fell on deaf ears. As the company's position deteriorated, however, senators and representatives from affected states became increasingly active. In June 1979, Riccardo met with administration officials to seek legislation that would permit the company to convert its mounting tax losses into a \$1 billion cash advance, but the Carter Administration still was not receptive. The Treasury Department feared that any such plan would pervert the tax code and open the floodgates to other companies in dire straits. Nevertheless, Treasury officials organized a task force to gather information on Chrysler and devise alternatives.

By August, the Carter Administration had decided to help Chrysler. It

33. Interview with officials of Manufacturers Hanover Trust Co. (names withheld by request), in New York City (Jan. 10, 1984) [hereinafter cited as Manufacturers Hanover Interview].

was likely that Congress would act even if the Administration did not. In addition, Douglas Fraser, president of the United Auto Workers Union, and Coleman Young, Mayor of Detroit, had impressed upon the President and his immediate staff the importance of maintaining Chrysler jobs. With an election little more than one year away, their advice struck a responsive chord. On August 9, 1979, G. William Miller, the newly-appointed Secretary of the Treasury, met with Chrysler's board of directors. He told them that the administration would support neither the tax plan nor regulatory relief, but might be persuaded to introduce legislation guaranteeing up to \$750 million in new loans if the company came up with an acceptable restructuring plan, including financial concessions from lenders, employees, dealers, and state governments.³⁴ Another requirement—well understood, although unstated—was that John Riccardo would step down as chairman of the company.³⁵

Riccardo resigned and Lee Iacocca, who had come to Chrysler from Ford in 1978, took over. The firm hired an investment banking firm and a management consultant to help devise its restructuring plan. It also shifted its public-relations strategy: the firm no longer argued that relief was warranted by the burdens of the government's tax and regulatory policies; instead, it blamed itself for past failures, but warned that a bankruptcy would force 600,000 people out of work. It also shifted its lobbying efforts from Congress's tax committees to the banking committees.

Chrysler and the Treasury negotiated throughout October 1979. Secretary Miller continued to demand that the plan include larger financial concessions from the banks and employees, and that the earnings projections on which the plan was based be better substantiated. The Treasury commissioned several independent studies of Chrysler, the automobile industry, and the possible effects of a Chrysler bankruptcy. Meanwhile, Chrysler's cash situation continued to deteriorate. Its losses for the third quarter reached more than \$450 million. No company in history had lost so much money in so short a time. Chrysler was approaching default on its loans. Its share of the U.S. automobile market was now down to less than nine percent.

Chrysler's congressional allies were growing impatient. Senator Don Riegle and Representative James Blanchard, both from Michigan and both members of their respective chambers' banking committees, introduced loan guarantee legislation. Both committees held hearings at which Lee Iacocca, Douglas Fraser, and Coleman Young argued for loan guar-

34. Interview with G. William Miller, former Secretary of the Treasury, in Washington, D.C. (Jan. 17, 1984) [hereinafter cited as Miller Interview].

35. *Id.*

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antees. John McGillicuddy of Manufacturers Hanover explained that Chrysler executives have “substantially exhausted their remedies in the private sector, from a lending point of view, and are now in a position where they need Federal assistance if they are to implement their plan and bring their organization back on its feet.”³⁶

On November 1, 1979, Secretary Miller announced the administration’s support for a \$1.5 billion loan guarantee. He explained that the administration’s original estimate of \$750 million was far short of what was needed to put Chrysler back on a sound footing.³⁷ Immediately, Chrysler swung into action, seeking congressional relief before the end of the year. Chrysler dealers, members of the United Auto Workers (UAW), and key suppliers all visited congressional offices, armed with printouts showing Chrysler and Chrysler-related jobs in each district. There was no organized opposition, save for relatively weak lobbying by the National Association of Manufacturers, the National Taxpayers Union, and Ralph Nader’s Congress Watch.

Nevertheless, certain members of Congress did press for specific provisions in the loan guarantee legislation. At the behest of Senator Russell Long, the proposal was amended to include an employee stock ownership plan.³⁸ Senators Richard Lugar and Paul Tsongas held out for greater concessions from the employees.³⁹ Other members simply opposed the whole idea on the basis that the “free market” should be allowed to work its will.⁴⁰

The final bill was enacted on December 20 in the House and on the following day in the Senate.⁴¹ A few weeks later, in a subdued White House ceremony, President Carter signed the Chrysler Loan Guarantee Act while Douglas Fraser and Lee Iacocca watched. The law provided guidelines for approximately \$2 billion of financial concessions required of the banks, employees, dealers, suppliers, and states, to be matched by \$1.5 billion of federal loan guarantees.⁴² It also established a loan guarantee

36. *Chrysler Corp. Loan Guarantee Act of 1979: Hearings on H.R. 5805 Before the Subcomm. on Economic Stabilization of the House Comm. on Banking, Finance and Urban Affairs*, 96th Cong., 1st Sess. 824 (1979) (statement of John McGillicuddy, Chairman, Manufacturers Hanover Trust Co.) [hereinafter cited as *House Hearings*].

37. *N.Y. Times*, Nov. 2, 1979, at 1, col. 6.

38. 125 CONG. REC. 27,180-81 (1979).

39. 125 CONG. REC. 36,638-44 (1979).

40. *See, e.g.*, 125 CONG. REC. 37,059 (1979) (statement of Sen. Goldwater) (“I think this [bailout of Chrysler] is probably the biggest mistake that Congress has ever made in its history.”); 125 CONG. REC. 36,220-22 (1979) (extension of remarks of Rep. D. Crane) (“Clearly, such largesse [to the Chrysler Corp.] would be the end of the free enterprise system.”).

41. Chrysler Corporation Loan Guarantee Act of 1979, Pub. L. No. 96-185, 93 Stat. 1324 (1979) (codified at 15 U.S.C. §§ 1861-1875). The authority of the Loan Guarantee Board to issue new guarantees for loans to Chrysler expired on December 31, 1983. 15 U.S.C. § 1875 (1982).

42. 15 U.S.C. § 1863(c) (1982) (requiring \$1,430,000,000 in concessions from creditors); §

board comprised of the Secretary of the Treasury, the Chairman of the Federal Reserve Board, and the Comptroller General to monitor the company's compliance with the legislation and to authorize issuance of guarantees upon finding that the company continued to be "viable."⁴³

Chrysler's losses for the year totaled \$1.1 billion. Iacocca said, "The hard part starts now"⁴⁴—getting the various groups to agree to come up with \$2 billion worth of concessions. Chrysler's workers were the first to cooperate. Annual pay increases specified in the industry-wide "pattern" contract (which Chrysler workers already had agreed to delay in their October contract talks) would be postponed further, putting Chrysler workers six months behind Ford and General Motors employees that year and another five-and-one-half months behind the next year. The 250-member Chrysler Council approved the new contract on January 9, 1980; three weeks later it was approved by more than seventy-five percent of the workers voting in seventy-five Chrysler locals. One UAW official explained the large margin of victory: "The debate in Congress over federal aid and all the publicity convinced them. They voted to save their jobs."⁴⁵ In addition, the UAW leaders agreed to allow Chrysler to postpone its periodic payment to the union pension fund. Chrysler viewed this as a "contribution" worth \$413 million, even though the government, as insurer of pensions through the Pension Benefit Guarantee Corporation,⁴⁶ ultimately would pick up the tab should Chrysler fall into bankruptcy.

Creditors were more recalcitrant. The Act required that creditors contribute \$650 million in loan concessions.⁴⁷ But by January Chrysler had stopped paying both principal and interest on its outstanding debt. It was now technically in default, and some lenders argued that their forbearance from seeking bankruptcy was a form of contribution. Many of the 400 lenders were convinced that Chrysler eventually was going to fail. They feared that the government loan guarantee, which had priority over their claims, would only drain away assets that might otherwise go to the banks at liquidation. The banks also fought among themselves: European banks, and some small U.S. banks, demanded payment in full from the larger U.S. lenders. Some banks seized funds Chrysler had deposited with them and applied the funds against Chrysler's debts. The larger U.S.

1865(a)(1) (requiring \$462,500,000 in concessions from Chrysler employees); § 1867 (limiting Board authority to extend loan guarantees to \$1,500,000,000).

43. 15 U.S.C. § 1862 (1982).

44. N.Y. Times, Jan. 8, 1980, at D1, col. 5.

45. Detroit Free Press, Feb. 2, 1980.

46. 29 U.S.C. §§ 1301-1309 (1982).

47. 15 U.S.C. § 1863(c)(1) (1982) (requiring at least \$500,000,000 from U.S. banks, financial institutions, and other creditors in the form of new loans or credits); § 1863(c)(2) (requiring at least \$150,000,000 from foreign banks, and other creditors).

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lenders insisted that every lender must sacrifice directly in proportion to its outstanding loans. Negotiations dragged on through March and April, with Chrysler and Manufacturers Hanover executives trying to strike a deal with the others. Eventually the lenders agreed to defer certain debt payments until after 1983, in exchange for \$200 million in Chrysler preferred stock.

The new plan which Chrysler submitted to the Loan Board at the end of April did not meet the legal requirements set out in the Loan Guarantee Act. State and local governments had not yet committed funds; suppliers and dealers only had agreed to "softer" terms on purchases; the lenders' agreement to defer payments did not represent "new" money for Chrysler. Nevertheless, the Loan Board conditionally approved the plan.⁴⁸ Chrysler would receive \$500 million in loan guarantees so long as the various parties actually came up with the sacrifices to which they had agreed.

Despite the Loan Board's leniency, the deal almost fell through. A few small banks and several foreign banks still held out. By June, Chrysler was without cash. It stopped paying its suppliers. Had they then stopped supplying Chrysler, the company would have shut down. Secretary Miller and his staff, now firmly committed to Chrysler's plan, applied pressure. They met with the bank officials, explained that with anything less than one-hundred-percent participation the entire deal would unravel, and subtly threatened retaliation.⁴⁹

Final agreement was reached on June 24. Chrysler received its \$500 million loan guarantee. The Loan Board approved a second draw-down of up to \$300 million on July 15, 1980.⁵⁰ The transaction, said Lee Iacocca, represented "the most complex financial restructuring program in history . . . for one purpose—to protect the jobs of 600,000 American workers who build American cars for American buyers."⁵¹

Throughout this period, Iacocca and other Chrysler executives reported monthly to Secretary Miller, and daily to the Loan Board staff. "We were like a board of directors," Miller said. "I tried to convince them that they could no longer be a big car company, offering a full range of models.

48. The conditions are set forth in STAFF OF SUBCOMM. ON ECONOMIC STABILIZATION OF THE HOUSE COMM. ON BANKING, FINANCE AND URBAN AFFAIRS, 96TH CONG., 2ND SESS., FINDINGS OF THE CHRYSLER CORPORATION LOAN GUARANTEE BOARD 39-45 (Comm. Print 1980).

49. Interview with Wendell Larsen, former Chrysler Vice-President for Public Affairs, in Chicago, Ill. (Feb. 14, 1984). Legislation affecting bank regulation was pending in Congress; in addition, one member of the Loan Board was Chairman Paul Volcker of the Federal Reserve Board, the government agency which directly regulated many of the banks.

50. STAFF OF SUBCOMM. ON ECONOMIC STABILIZATION OF THE HOUSE COMM. ON BANKING, FINANCE AND URBAN AFFAIRS, 96TH CONG., 2ND SESS., REPORT OF THE CHRYSLER CORPORATION LOAN GUARANTEE BOARD 10-14 (Comm. Print 1980).

51. L. Iacocca, Statement at Press Ceremony (June 25, 1980).

They had to downsize the firm. They resisted the notion at first."⁵² This resistance, however, soon disappeared. Chrysler abandoned the full-size car business, cut its production, and concentrated on compacts and sub-compacts, including the much-vaunted K-car. Plants were closed, with corresponding cuts in employment. When a UAW official charged in October 1980 that the Loan Board was putting "undue pressure on Chrysler Corporation to strip down its operations," Secretary Miller insisted that the Board's "sole objective" was to put Chrysler back on a "sound financial and operative plan."⁵³

Despite the new money, Chrysler's plight did not improve. The K-car did not sell, in part because the Federal Reserve Board was drastically restricting the money supply, forcing interest rates to more than twenty percent and thereby discouraging automobile sales. By the end of 1980, Chrysler was back to the Loan Board for a third installment. This time Secretary Miller and the Board demanded even greater sacrifices from the constituent groups. The Board held all the cards: if the Board did not approve additional loan guarantees soon, responsibility for resolving the situation would shift to the Reagan Administration, which was not likely to be sympathetic.

Miller summoned Chrysler executives, bankers, and union officials to an eleventh-hour meeting at the Treasury Department in early January 1981. There he met separately with representatives of each group, squeezing them for more concessions. In the end, the union agreed to cut wages by \$1.15 an hour and freeze them at that level until September 1982; the banks agreed to convert \$1 billion of Chrysler's \$2 billion debt into preferred stock, and accept repayment on the other half at a rate of thirty cents on the dollar. No one was happy with the deal. William Langley, an executive from Manufacturers Hanover, claimed that the banks had been forced to the wall and had borne the brunt of the sacrifice.⁵⁴ Douglas Fraser called it "the worst economic settlement we ever made. The only thing worse is the alternative—which is no jobs."⁵⁵ The Board approved a final installment of \$400 million in loan guarantees.

Chrysler came back from the dead, earning a small profit in 1982. Helped by the strong upturn in the U.S. car market in 1983, the company earned more than \$700 million, a swing of more than \$1 billion from the same period two years before. Chrysler had cut its long-term debt from \$2.15 billion in 1983 to \$1.07 billion, paid \$116.9 million in back divi-

52. Miller Interview, *supra* note 34.

53. N.Y. Times, Oct. 21, 1980, at D5, col. 4.

54. Interview with William Langley, Executive Vice-President of Manufacturers Hanover Trust Co., in New York City (Jan. 10, 1984).

55. N.Y. Times, Jan. 25, 1981, § 3, at 15, col. 2.

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dends on preferred stock, strengthened its capital structure by exchanging \$1.1 billion in preferred stock and warrants for common shares, and retired 14.4 million warrants held by the Treasury for \$311 million. Its share price rose to \$35 during the summer of 1983—more than seven times higher than its low in 1982.

The company was now “lean and mean,” in the words of Lee Iacocca.⁵⁶ Its production capacity had been slashed to approximately 750,000 cars, down from a peak of almost 1.6 million in 1968. Its total employment was down to approximately 70,000, from 160,000 just five years before (U.S. employment shrank from 110,000 to 60,000). It produced far fewer models, had no foreign subsidiaries (except for a plant in Mexico), had a far smaller budget for developing new models and technological innovations (though it was now producing several new models, including a highly successful mini-van), and was relying heavily on Japanese producers to fill out its product line and supply it with technology. Nevertheless, the company had survived and had, according to Iacocca, “won its long battle for independence.”⁵⁷

II. Patterns

These four cases appear to have a great deal in common. Each manufacturing company was highly successful in the past. Each expanded rapidly during the boom years of the 1960's, becoming extremely large by the start of the 1970's. Each had difficulty consolidating and “digesting” its expansion. Each became deeply in debt. In each case, the combination of past successes and the rapid build-up made the company unable or unwilling to change direction, even in light of signs that the market for its products was leveling off or declining. Each company therefore was highly vulnerable to the oil shocks, deep recessions, and sharp changes in international competition which characterized the middle and late 1970's.

In addition, each of these companies was a major regional employer. By the early 1970's, each accounted for five to ten percent of the manufacturing jobs in areas like the State of Niedersachsen in West Germany, the British Midlands around Coventry and Liverpool, the Hiroshima Prefecture in Japan, and the Great Lakes region around Detroit and northern Ohio. Each also purchased a significant percentage of materials and components produced within the region or in regions nearby. Although estimates of indirect employment vary, each of these companies clearly had a pivotal position within at least one regional economy, producing the larg-

56. Interview with Lee Iacocca, President of Chrysler Corp., in New York City (Nov. 9, 1983).

57. N.Y. Times, Feb. 24, 1984, at 3, col. 1.

est item of trade between the region and the national and world economies, and thereby supporting countless smaller businesses producing both goods and services.⁵⁸

In each instance, the first clear sign of crisis was a shortage of cash which compelled company executives to seek additional short-term credit from the company's lead bank. Within months, the shortage of operating capital grew significantly. Losses ballooned. Company executives denied the extent of the crisis. They continued to view it as a temporary cash-flow problem which would sort itself out as soon as the economy improved, when the company developed a technical "fix" for its declining competitiveness, or when its new product line was unveiled. In each case the lead bank forced the company's hand by refusing to make additional loans.

As the crises deepened, control of each company shifted out of the hands of the incumbent executives to a third party which oversaw the transition to a new management team. This third party also negotiated with the various interests who had a continuing stake in the company, seeking financial sacrifices from them in order to keep the company going. In return, the third party agreed to bear a considerable share of the cost itself, including the investment of new money. Although government was involved in every case, the third party was the lead bank for AEG-Telefunken and Toyo Kogyo; for British Leyland and Chrysler the third party was a government agency.

There is, however, a deeper set of comparisons to be drawn. In none of these four cases was the company formally liquidated. Although AEG-Telefunken resorted to a limited type of formal reorganization under court protection, in none of the cases did a receiver or trustee oversee a full, formal reorganization under the bankruptcy laws. Nevertheless, a reorganization of sorts did take place. The companies were refinanced and reorganized, assets were redeployed, new products were developed, and various parties had to sacrifice in the short term for the sake of longer-term rewards. Parts of the companies were "liquidated" in the sense that certain assets were sold off and employees let go. In each case the bailout was effected by a mix of shrinking the company and shifting some workers and assets.

58. *AEG: Weltfirma am Abgrund*, DER SPIEGEL, Nov. 19, 1979, at 75 (discussing the role of AEG in the West German economy); RYDER REPORT, *supra* note 16, app. B, at 74 (discussing regional employment by BL); Interview with Ichiro Maeda, Assistant General Manager of Toyo Kogyo for Corporate Planning, in Hiroshima, Japan (Sept. 16, 1983) [hereinafter cited as Maeda Interview] (discussing effects on Japan); *The Chrysler Corp. Financial Situation: Hearings before the House Subcomm. on Economic Stabilization of the House Comm. on Banking, Finance and Urban Affairs*, 96th Cong., 1st Sess. 187-227 (1979) (report on the employment and economic effects of a shutdown or major reduction of business by Chrysler).

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A. *Shrinking the Company*

Given the size and importance of these companies, the groups requesting government aid argued that the free market and the profit motive on which market transactions are based could not be relied upon to ensure the well-being of citizens dependent on the enterprise. And yet, paradoxically, each of the companies ended up substantially smaller than it was originally.⁵⁹ This paradox appeared repeatedly in public discussions and debates over what to do about these companies: the company had to be saved because so many people were dependent on it, but the only way to save it was to reduce drastically its size and thereby harm the very people who depended on it. Market processes, including bankruptcy, would result in a significant portion of the company being sold off or liquidated for scrap, so it was necessary to subsidize the company while it sold off or liquidated a significant portion of itself.

The bailout of AEG-Telefunken is a case in point. Count Lambsdorff justified the West German government's decision to provide AEG-Telefunken with loan guarantees by reference to how important the firm was to the West German economy.⁶⁰ His secretary, Otto Schlecht pointed to the hundreds of thousands of workers who depended on the company and the 30,000 separate companies which provided it with materials and supplies, and noted that a "[bailout] in this instance is less costly for Germany than bankruptcy."⁶¹ But Lambsdorff had approved the loan guarantees only after an independent audit concluded that the company could survive as long as it continued to cut drastically its size and payroll.

We see a similar apparent inconsistency in the case of Toyo Kogyo. Tsutomu Murai, managing director of the Sumitomo Bank, who took over as vice president of Toyo Kogyo, made the rounds of business leaders in Hiroshima to assure them that the bank's intention in taking over the troubled company was to save jobs. The bank also requested assistance from the prefecture on the same grounds. The new Toyo Kogyo managers then proceeded to cut employment. "Obviously, we had to reduce costs," one bank official later explained, "and labor costs are among the most important to reduce."⁶²

The same tension was present in the British Leyland case. The initial

59. AEG-Telefunken shrank from 105,000 West German employees at the start of the crisis to 60,000 by the time it was over (a 43% drop in employment); British Leyland, from 211,000 to slightly more than 100,000 (52%); Toyo Kogyo, from 37,000 to 27,000 (27%); and Chrysler, from 110,000 U.S. employees to around 60,000 (45%).

60. *Fin. Times*, July 15, 1982, at 1, col. 1.

61. Schlecht, *Darf der Staat sanierungsreifen Unternehmen helfen? [Should the Federal Government Support Enterprises That Have Economic Problems?]*, WIRTSCHAFTSDIENST, Sept. 1982, at 423, 425.

62. Yamada Interview, *supra* note 28.

debate in Parliament⁶³ clearly pitted Conservative against Labour, free-market ideology against the socialization of costs. The conservatives argued that the free market should be allowed to function, that letting BL go bankrupt would facilitate the redeployment of labor and capital to more efficient uses. Labour countered by focusing on the hardships such a bankruptcy would impose on the many people dependent on the automaker.⁶⁴ Not surprisingly, the initial Labour plan for British Leyland relied on a combination of new investment and more participation by the workers in company management to restore the company to profitability.⁶⁵ There was no mention of reducing the size of the company and cutting its work force. Indeed, Lord Stokes, British Leyland's chairman, publicly criticized this lack as the "worst aspect" of the plan.⁶⁶ Just two years and more than \$500 million later, the Labour government's National En-

63. 892 PARL. DEB., H.C. (5th ser.) 1419-1538 (1975).

64. Mr. Enoch Powell summed up the Conservative view:

[W]hat bankruptcy brings about, and it does so harshly, is to make it possible for the resources which have been devoted to making a loss to be reapplied in ways which are more likely to make a profit.

We use the terms "loss" and "profit", but they disguise a much cruder reality—and that cruder reality is destruction and creation. When men are employed in an undertaking which, year after year, is making a loss, those men—who are the last people to blame—are actually destroying that which their fellow workers are creating. Less is going out than comes in; they are involuntary parasites upon the economy. The benefit which bankruptcy confers, the benefit which makes it indispensable, is that it enables resources which would otherwise be locked in the work of destruction to be released for different applications, different combinations, different circumstances, in which they can again be creative.

Immediately, however, public money comes upon the scene, immediately public money is to be injected into an undertaking, all the criteria which would otherwise be brought to bear fly out of the window and are replaced by a very different outlook. The private, cautious, calculated, experienced, almost cynical estimation of the likely prospects for the future is replaced by the public commitments, by the political pressures and by the freedom from responsibility which comes out of spending public money, money which is there to hand. . . .

[B]ankruptcy is indispensable and . . . there is no substitute for the judgment of bankruptcy and for the liberating power of bankruptcy.

Id. at 1481-84.

Tony Benn, Secretary of State of Industry in the Labour government, responded to Powell and several other Tories:

I am listening intently to the hon. Gentleman, who speaks with great clarity and seriousness on these matters, but the more I listen to him the more I am utterly convinced that his argument leaves out of account that there is not only the balance sheets but the ballot box. He speaks of people as if they can be moved at the behest of the owners of industry without regard to the political and social factors which are the basis of our standing in the House . . . [T]he people represented through the ballot box intend to exercise, and do exercise, a countervailing power to the use he would wish to make of them as pawns in a financial game.

Id. at 1493.

Soon after the Parliamentary debate, Keith Joseph, a member of the Conservative Shadow Cabinet who was to be Secretary of State for Industry in the Thatcher government, condemned Benn's position: "In order to preserve jobs in over-manned, inefficient British Leyland, Mr. Benn will take astronomical money from the rest of the country and thus cause many other firms to fail. . . . Mr. Benn is the real manufacturer of poverty." *Fin. Times*, May 3, 1975, at 1, col. 3.

65. *Our Very Own British Leyland*, *ECONOMIST*, Apr. 26, 1975, at 88.

66. *Fin. Times*, May 8, 1975, at 1, col. 3.

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terprise Board hired a new chief executive for the company who, with the full approval of the government, set about slashing its work force.⁶⁷ By then it was clear that such cuts were the only way to save the company.

When the Conservatives regained power in 1979, the reduction in employment at BL was well underway. Job cuts accelerated over the next two years. At the start of 1981, however, Margaret Thatcher's government decided to give British Leyland more than \$2.4 billion, a far larger infusion of new equity than had ever been contemplated by the Labour Party, because Sir Geoffrey Howe, the Chancellor of the Exchequer, had determined that liquidation of the firm would increase unemployment in Britain by 150,000 people (including the employees of suppliers), and thereby boost public welfare spending by approximately \$7 billion a year.⁶⁸ Keith Joseph, the Industrial Secretary who approved the payment, told the press: "We tried to find a middle way but there was no middle way. Whether we accepted or rejected [British Leyland's request for more aid] the taxpayers would have been clobbered."⁶⁹

The debate in the United States over Chrysler followed a similar path. In the congressional hearings on the loan guarantee, Detroit's Mayor Coleman Young cited estimates that a Chrysler bankruptcy would double the number of unemployed in Detroit to about twenty percent of the city's population.⁷⁰ Other cities would be hit hard as well: the Wilmington-Newark, Delaware area would lose 14,000 jobs; St. Louis would lose more than 25,000; Syracuse, N.Y., and Huntsville, Alabama would have their unemployment rates doubled; Newcastle, Indiana, would lose one-third of its jobs; Kokomo, Indiana, faced a forty percent cut in its jobs.⁷¹ The individual suffering caused by such losses would be considerable:

[A]lthough economic theoreticians may be comforted by the fact that over the long term our economy would adjust, this is no comfort to those in so many of our cities who face the loss of a job. Because of age, some of those, as a matter of reality, will never be able to find a job again, or at least will never be able to find a job at anything close to comparable wage rates or in the places where they now live.⁷²

Congressman Jim Wright, the House Majority Leader, urged his col-

67. Ball, *Saving Leyland is a Job for Hercules*, FORTUNE, July 3, 1978, at 58, 61.

68. *BL: It's the Thought that Counts*, supra note 22, at 48; *Brighter Future for British Cars?*, NEWSWEEK, Feb. 9, 1981, at 77.

69. *Brighter Future for British Cars?*, supra note 68, at 77.

70. *Chrysler Corporation Loan Guarantee Act of 1979: Hearings on S. 1965 and S. 1937 Before the Senate Comm. on Banking, Housing and Urban Affairs*, 96th Cong., 1st Sess. 1033 (1979) (statement of Coleman Young, Mayor of Detroit) [hereinafter cited as *Senate Hearings*].

71. *Id.* at 1032.

72. *House Hearings*, supra note 36, at 343 (statement of Coleman Young, Mayor of Detroit).

leagues to support the aid bill, arguing that a Chrysler bankruptcy would cost the federal government \$14 billion to \$15 billion and plunge the nation into a full-scale recession.⁷³ The \$15 billion figure included \$11 billion in lower taxes and higher welfare and unemployment payments, a \$1.1 billion drain on the Pension Benefit Guarantee Corporation, and a \$3 billion rise in the trade deficit as foreign cars picked up much of Chrysler's market share. Wright warned that the failure of Chrysler would trigger an economic calamity. A loan guarantee would be in keeping with the tradition that says if "your neighbor's barn caught fire and burned down, then all of the rest of those who lived in the community would provide a little bit of their substance to help and that that was part and parcel of the American spirit."⁷⁴

These sentiments were opposed by those who urged that the market be allowed to work its will. Walter Wriston, the chairman of Citicorp, testified against the loan guarantees:

There is no avoiding the fact that it is an attempt by the Government to move economic resources to places where they would not otherwise go. Such distortions inevitably lead to less, not more, productivity—and therefore to fewer jobs, less return on investment, and fewer bona fide lending opportunities for banks and everyone else.⁷⁵

Peter G. Peterson, chairman of the investment banking firm of Lehman Brothers Kuhn Loeb, Inc., and a former Secretary of Commerce under the Nixon Administration, warned that a loan guarantee would make Chrysler a permanent ward of the state: "There is clearly a grave danger here that the ultimate costs of government assistance may escalate far beyond the initial projections and that even then, the problem will not have been resolved."⁷⁶ Peterson implied that he would let Chrysler fail rather than set a precedent for other federal bailouts.⁷⁷ His sentiments were echoed by the Business Roundtable, a group of chief executives of very large companies, which issued a statement in opposition to the loan guarantees: "Whatever the hardships of failure may be for the particular companies and individuals, the broad social and economic interest of the nation are best served by allowing this system to operate as freely and as fully as possible."⁷⁸

The proponents of the loan guarantee, many hoping to save jobs, won

73. *Id.* at 684 (statement of Rep. Wright).

74. *Id.*

75. *Senate Hearings, supra* note 70, at 1286 (statement of Walter Wriston, Chairman, Citicorp).

76. *Id.* at 777 (statement of Peter G. Peterson, Chairman, Lehman Brothers Kuhn Loeb, Inc.).

77. *Id.* at 778.

78. 37 CONG. Q. 2752 (Dec. 1, 1979).

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the legislative battle. Once administration of the loan guarantee program was firmly in place within the Treasury Department, however, a different viewpoint seemed to predominate. Treasury officials were bent on restoring Chrysler to competitive health as soon as possible, thereby protecting the government's investment. "My job was to make sure that the government was protected," said Brian Freeman, who served as executive director of the Loan Guarantee Board. "That meant making sure that Chrysler was viable."⁷⁹ The objective of restoring Chrysler to quick health required that the firm cut costs and lay off workers. Treasury officials pushed Chrysler to drastically reduce its size. G. William Miller, who was Secretary of the Treasury at the time, talked about the difficulties involved:

The truth is Lee [Iacocca] didn't want a downsized company when we started this; we had to fight for it. We weren't on the same wavelength. The first proposal he gave me I just slid . . . back across the table and said, "you haven't thrown any ballast off yet. When the ship starts to sink, the first thing you do is get rid of ballast."⁸⁰

In the end, the Treasury view prevailed, and Chrysler shrank to almost half its size.

One way to explain the apparent shift in objective, from saving jobs at the expense of efficiency to saving the company at the expense of jobs, is to view the reorganization process as moving from a political to an administrative frame of reference. At the political stage, the company's plight is described as a public problem requiring a public response. Bankruptcy would result in huge social costs, falling disproportionately on certain groups of people. Such a result would be unfair, and in any event would require vast public assistance. Therefore, it is far more equitable, and less costly to the public, for the company to be given special aid.

With the political battle won, the problem then becomes one of administering aid to the troubled company. Financial specialists now take charge. Their professional training is in helping companies to improve their cash flow and balance sheets, not in keeping people employed. They are judged by how quickly they restore companies to financial health, not by how well they maintain the income streams of employees and subcontractors. They work within ministries of finance, treasury departments, and commercial loan departments of large banks—institutions whose traditional roles involve ensuring fiscal responsibility and prudence, rather

79. Interview with Brian Freeman, former Executive Director of the Chrysler Loan Guarantee Board, in Cambridge, Mass. (Feb. 2, 1984).

80. Miller Interview, *supra* note 34.

than promoting social welfare or distributional justice. These administrators naturally come to see their task as making a financial “deal” similar to other deals with which they have been associated. Former Secretary of Treasury G. William Miller described the Chrysler loan guarantee from the vantage point of the Treasury Department:

It was just a professional reorganization outside of bankruptcy. One of the problems of doing it as public policy is that you can't count on every administration to have people in place who can do that sort of thing. We happened to have a set of industrialists and lawyers who were not strange to deals like this.⁸¹

Because the political mandate to save jobs inevitably is short-lived, and because political agendas are crowded and public attention can be focused on such a problem for only a short time before other issues predominate, administrators have considerable leeway in shifting to the objective of saving the company and minimizing the financial exposure of their own institution, even at the expense of jobs. Moreover, a goal like “saving jobs” is difficult to define and measure with certainty; by the time the crisis is apparent, many jobs already will have been lost, and additional job losses are to be expected. The administrators, however, face at least two constraints on their discretion.

The first is the limited ability of democratic politics to withstand the pressures generated by extremely rapid change: political and administrative goals are precariously balanced. If administrators move too quickly to restore the company through cuts in employment, the issue may move back into the political realm. We see elements of this constraint in all four cases. In the AEG-Telefunken rescue, Dresdner Bank officials justified an industry-led bailout to other banks and insurance companies on the ground that continued rapid job losses otherwise would force a political solution. When this “private” bailout itself began to result in rapid job losses, labor leaders pushed for nationalization of the company.⁸² In the British Leyland case, after the National Enterprise Board finally acceded to substantial job cuts, the Labour Party grew deeply divided over the proper course of the rescue, with back-benchers calling for a change in management.⁸³ As Sumitomo Bank executives began to shrink Toyo Kogyo, leaders of Hiroshima expressed growing concern, with the implicit

81. *Id.*

82. See, e.g., *Labor is Bracing for AEG's Collapse*, BUS. WK., Sept. 6, 1982, at 42, 43; Fin. Times, Aug. 12, 1982, at 16, col. 2.

83. *Can British Leyland Survive?*, NEW STATESMAN, Jan. 27, 1978, at 108-09.

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threat of political recourse if the situation grew markedly worse.⁸⁴ When the Loan Guarantee Board began to press Chrysler to reduce its size, labor leaders pressed Congress and the Carter Administration to intercede.⁸⁵ Under this view, the threat of political intervention caused these administrators to temper their enthusiasm and slow down their efforts to save the company by cutting labor costs.

This shift from a political to an administrative frame of reference, however, cannot explain the administrators' apparent willingness to pour additional funds into the company, and their corresponding reluctance to allow the company to fall into bankruptcy, even when it showed no signs of revival. This tenacity is particularly interesting in the two cases in which governments ostensibly committed to the free market significantly increased public assistance, at a time when both companies seemed destined for eventual bankruptcy: AEG-Telefunken under a fragile coalition between the Social Democrats and the conservative Free Democrats and British Leyland under the Conservatives. When asked to explain their sharp departures from party ideology and rhetoric, both West Germany's Count Lambsdorff and Britain's Keith Joseph pointed out that providing government assistance to the company was far cheaper than providing it to all the people who would be unemployed in the event of a bankruptcy.⁸⁶ Each government had every incentive to do its calculation carefully, taking full account of any segments of the company that probably would find another use in short order. Nevertheless, each determined that company assistance would be cheaper than social assistance.

At first blush this conclusion seems especially curious, coming as it does from conservative leaders, none of whom was particularly dependent on labor support. To be sure, the rather generous programs of unemployment assistance for which unemployed workers are eligible in these countries are themselves the results of earlier political compromises. But even with these social programs firmly in place, it seems strange that these governments would have preferred subsidies for the ailing companies. Though costly, unemployment insurance at least would permit workers to find alternative employment eventually. Bankruptcy at least would allow assets of the ailing company to be released into the economy, eventually to be put to better use. The bailout alternative might be a permanent drain on public resources, and a permanent misallocation of resources in the economy. One would expect free marketeers to argue that though in the

84. Yamada Interview, *supra* note 28.

85. Interview with Douglas Fraser, former President of the United Auto Workers, in Washington, D.C. (Oct. 19, 1983).

86. See, e.g., *supra* text accompanying notes 61 and 69.

short term it may be more expensive to allow the company to go under, in the long term this route is far cheaper than any other.

The surest explanation for the support of free market advocates for corporate bailouts is that company assistance was not seen as a permanent subsidy. It was, rather, a means of *slowing down* the inevitable shrinkage of the enterprise. Bankruptcy would work too quickly; the resulting market disruption would be too great. If the company suddenly dissolved its least competitive parts, large numbers of workers in particular regions of the country would simultaneously lose their jobs. This sudden burst of unemployment would have devastating effects on the economy, with multiplier effects as suppliers and services lost customers and could not collect on accounts. By extending the decline over a longer period of time, however, policymakers could ease the adjustment. Fewer people would be out of work at any given time, and growing businesses might be able to absorb many of them. Suppliers might lose the failing company as a customer, but would have time to develop alternative customers. Fewer workers and small businesses would face a credit crunch, and this would reduce the pressure on other small businesses, services, and lending institutions. Seeing the coming decline, creditors and shareholders also could make gradual adjustments, writing down their loans and altering their portfolios with minimal disruption. In short, given the size and importance of these companies to their economies, bankruptcy would release vast resources far more quickly than the market could absorb them. What was needed, therefore, was *slow* bankruptcy. This need is the source of the second constraint on administrative discretion: the reduction in the size of the company must be sufficiently gradual so as not to cause severe economic problems.

As we have seen, the shift from a political to an administrative frame of reference—with the ever-present possibility that the issue would regain public attention—also meant a slow shrinkage of the company. Under this view, the administrators' willingness to provide additional assistance to the company and thereby slow down the decline was a response to political reality. If the shrinkage were too rapid and the resulting unemployment too great within a particular time period, there would be political demands to preserve the status quo. These demands in turn would make it difficult, if not impossible, to restore the company to financial health. The administrators' goal, therefore, was to shrink the company as fast as politics would permit in order to regain solvency and protect their institutional investment. Under the slow bankruptcy view, on the other hand, a very different constraint governed administrators' decisionmaking. This second constraint was imposed by the economy's limited ability to adjust to extremely rapid change. Operating under this limitation, the administrators'

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goal was to shrink the company only as fast as the economy would permit in order to ease the process of economy-wide adjustment.

The British Leyland bailout seems to have moved from concern with the first constraint to concern with the second over its seven-year course. Between 1975 and 1977, when the issue of saving British Leyland jobs was highly politicized, there were almost no layoffs. Between 1977 and 1979, still under the Labour government, the National Enterprise Board and BL's new executives cut employment by about 30,000, a pace that was as fast as these administrators could manage without politicizing the issue once again. Between 1979 and 1981 the Conservatives, unconcerned about union support, cut employment by almost 50,000. However, in 1981, faced with the possibility of an even more rapid dissolution, the Tories held back. The social costs of unemployment were rising, not just for former BL employees and subcontractors, but for the nation as a whole, and it seemed that a quicker decline would imperil the entire economy. The Thatcher government decided to give BL a major infusion of new capital. Job cuts thereafter slowed down to the earlier pace of around 15,000 per year.

The Chrysler pattern is slightly different. In this case, the greatest number of layoffs—30,000 of them—came in 1979, the very year that Chrysler was ostensibly seeking government assistance to save jobs. The magnitude of the layoffs served to put Chrysler on the political agenda. In 1980 and 1981, after the issue had moved from Congress to the Treasury Department, the pace of layoffs slowed. About 17,000 workers were laid off during those two years. As we have seen, once the loan guarantee legislation was passed, the Treasury Secretary and the staff of the Loan Board urged Chrysler to slim down. It is interesting to note, however, that by then Chrysler had already done most of its slimming. Had Chrysler maintained the same pace of layoffs in 1980 and 1981 that it had in 1979, the company would have ended 1981 with a mere 10,000 employees—fewer than were expected to be employed after a formal bankruptcy. Presumably the company would have cut back its suppliers to a similar degree. However, given the problem of high, and rising, unemployment, particularly in the Midwest and the industrial belt of the Northeast, the social costs of such a sudden demise would have been prohibitive.

B. *Shifting Workers and Assets*

So far we have assumed that the only reason for subsidizing these companies was, paradoxically, to shrink them, but to do so more slowly than would have been possible had they been left to the market and bankruptcy. The evidence suggests this pattern, although it is unclear whether

it was attributable to financial administrators who were engaged in a kind of tug-of-war with politicians, or to economic ministers who were keeping a watchful eye on how quickly the economy could adjust to the company's gradual demise, or to some combination of both. To round out our discussion, however, we need to recognize another pattern in these cases. It concerns the shift which occurred within each company during its crisis toward more competitive products and processes, and better use of employees.

If the market for the company's products had irrevocably declined, or if the company had simply grown too large and ungainly to serve its market profitably, then we could understand the crisis simply as a failure of the company to shrink in a timely manner. Resources were kept too long, as if the company had erected a dam to block the natural outward flow of such resources in pursuit of more profitable uses. By the time the crisis appeared, the company was huge, and the dam extraordinarily high. If the dam broke, the pent-up resources would have inundated the economy, or else politics would have interceded to shore up the dam at all costs. The challenge was to reduce the reservoir of misallocated resources gradually, so that they could be absorbed elsewhere without igniting more political demands.

But this metaphor is too tidy. Markets change; new markets develop. Each company might have shifted its research, plant, equipment, cash, and employee resources in the direction in which the markets seemed to be moving or in the direction of new, emerging markets. In other words, to avert crisis the company whose old market was declining need not have watched passively as its productive resources flowed out to more profitable uses. It could have put its resources to better uses internally by shifting them to new products and more efficient processes. Even after the crisis occurred, the company still had the option of shifting instead of shrinking. The reservoir of misallocated resources lying behind the dam could have been rechanneled in other directions rather than simply allowed to flow out.

In each of our cases, some such shift occurred after the crisis broke. AEG-Telefunken invested anew in telecommunications and defense related technologies. British Leyland developed new automobile models, and improved the quality of its Land Rover and Jaguar. Toyo Kogyo invested in new models and the development of a fuel-efficient rotary engine. Chrysler developed several new compacts and a new mini-van. All these shifts appear to have been successful. All adapted to new markets. All entailed a redeployment within the company of certain resources, including people, that otherwise might have flowed out. All the shifts were en-

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couraged by the financial administrators who presided over the reorganization.

Shifting resources, however, requires money. New products must be designed and tested, plant and equipment converted, employees retrained, the production system reorganized, dealers prepared, and consumers re-oriented. The well-managed company, highly sensitive to potential changes and new opportunities in the market, is constantly investing in such shifts. On the other hand, the company that has disregarded such changes and new opportunities, or is caught unaware by a sudden shock to the market (such as that brought about by the introduction of a path-breaking technology or a substantial increase in the price of a raw material), may need to make a dramatic shift all at once, but lack the large sums necessary to do so. This was the problem faced by all four of the described companies. Once the crisis became apparent each of them shifted, but the shifts were only partial. The companies could not redeploy all of their resources internally because they did not have enough money to make a complete transition. In addition, because their market shares were declining and almost all their divisions were losing money, there was no likelihood of finding another company to purchase all or a substantial part of the ailing company.⁸⁷

To some extent, shrinking and shifting are complementary strategies for companies in distress. By liquidating the most costly and least profitable operations, cash flow is enhanced. The new cash can then be invested in shifting the remaining resources to more profitable uses. This shrink-and-shift strategy was used by all four companies to some degree. All cut their payrolls and, as we have seen, some of the revenues resulting from these changes were invested in new products and improved manufacturing processes.

The irony, of course, is that shrinking and shifting ultimately are inconsistent. Human and capital assets that flow out of the company no longer are available to be shifted. Even if the shrink-and-shift strategy is enormously successful—so much so that the shrunken company finds itself growing rapidly once again—the company may have difficulty summoning back old suppliers, employees, dealers, customers, and certain specialized assets. Time has elapsed. The discarded employees and suppliers are

87. Occasionally, parts of large failing firms may be sold off to other companies or groups of investors, who expect that—due to their superior managerial acumen or “synergistic” aspects of their other businesses—the newly spun-off divisions will offer a better return to them than they did as part of the failing firm. This occurred to a limited extent in Chrysler, which sold off its tank division; it occurred to a substantial extent in AEG-Telefunken, which sold off its consumer-products divisions. In these transactions, title to plant, equipment, and employees are transferred to the new owners. From a social standpoint, there has been no change, particularly no net loss of jobs. Wholesale transfers like these, therefore, may represent a socially preferable alternative to shrinkage.

likely to have linked up with other companies in the interim. Having once been jettisoned by the old company, they may be unwilling to resume what seems to be a precarious relationship. Under these circumstances it may be more costly for the company to bid them back and shift them to new uses than simply to find new suppliers, employees, dealers, customers, and specialized assets.

If markets adjusted to such changes with ease, and transactions such as these were relatively costless, then it would not matter what combination of shrinking and shifting were chosen. The company could be as profitable after a great deal of shrinking and a small bit of shifting as the other way around. The economy as a whole could adapt as easily to a dramatic shrinkage in one of its largest companies as to a major shift.

The selection of a balance between shifting and shrinking does matter, however. Markets do not always adjust with ease. Market transactions are costly because parties often have difficulty getting adequate information. Individual suppliers, employees, and other participants may find it difficult to attempt a shift for themselves—locating new uses for their services, determining precisely what retraining they need, and ferreting out reliable buyers and sellers. On the other hand, networks of suppliers, managers, employees, dealers, and customers who have dealt with one another over a long period of time may have a sufficiently subtle understanding of one another's needs and performance that transactions among them are highly efficient. Under these circumstances, it is likely to be less costly for the company to shift them as a group than for individual actors to engage in a large number of "retail" transactions among strangers.

Besides potential efficiency advantages of internal redeployment, there may be social advantages as well. Companies like these exist at the center of intricate social networks. They anchor communities and define relationships and obligations over time. They shape community values as they order social life. Their sudden demise may rend the community irreparably.

This is not to suggest that shifting is always preferable to shrinking, either for the company or for society as a whole. Even if workers, financial intermediaries, and other constituents were perfectly willing to invest in a wholesale shift, there simply may be no profitable alternative for the specialized networks of people that would justify the investment. The point is that shifting is *sometimes* preferable.

Such shifts nevertheless are unlikely to take place if each of the company's constituencies remains unwilling to sacrifice, either waiting for other constituents to make the first move, or appropriating assistance for its own outside uses. Under this logic, the outside assistance provided in the cases described above should have been used for shifting, rather than

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for compensating employees, suppliers, creditors, or other parties for sacrifices they were making in light of the cash crisis then affecting the companies. Otherwise, the assistance would simply amount to a transfer of wealth from one group (taxpayers or shareholders of the lead bank) to those being compensated. No real shift would occur.

The tension between wealth transfer and investment exists to a degree in all of our cases. For example, Alfred Kahn, then chairman of the Council on Wage and Price Stability, caused a stir when he pointed out that the initial deal struck between the United Auto Workers and Chrysler, while saving the firm between \$203 million and \$206 million in wages and benefits relative to the old contract, nevertheless would cost the company \$1.3 billion over current wages during the three years of the contract.⁸⁸ This amount was just shy of the \$1.5 billion loan guarantee that the company was seeking. Without more sacrifice from the union, therefore, it appeared that the government assistance would merely go into the pockets of Chrysler workers, leaving the company unchanged. As we might expect, more sacrifices were demanded as a condition of the loan guarantee. British Leyland, by contrast, did not have to cope with an Alfred Kahn. The bulk of government assistance to the troubled company in that case went to the workers for salary increases and severance payments, rather than toward new products and processes.

To the extent that the tacit goal of the assistance was simply to slow the pace of shrinkage, it did not matter that funds were diverted from investment into such payoffs. After all, the payoffs accomplished approximately the same underlying objective—they helped ease the pain of adjusting to a much smaller company by compensating those who otherwise would be hurt. But to the extent that new investment and internal redeployment was considered socially preferable to an “orderly” shrinkage and external redeployment, then the diversion was perverse. It prevented internal shifts.

Of all our cases, Toyo Kogyo shifted the most and shrunk the least. Its employment declined by only twenty-seven percent during the crisis. At the same time it completely transformed its manufacturing process and produced a wide array of new models. Most of the assistance provided to the company by the Sumitomo Group and, indirectly, by the regional and national governments, was invested in the shift. There were no payoffs, aside from continued interest payments to the banks on the company's accumulated debt. Suppliers and dealers continued to absorb losses; managers and employees took major cuts in wages and benefits; five thousand

88. *Senate Hearings, supra* note 70, at 701 (statement of Alfred Kahn, Chairman, Council on Wage and Price Stability).

production employees were temporarily transferred to dealers. Even when Toyo Kogyo sold its stock and real estate holdings to raise additional cash, it maintained the ability to summon these resources back to the fold, the purchasers being other members of the Sumitomo Group which, in effect, merely held these assets until Toyo Kogyo was able to reclaim them.⁸⁹ Thus, Toyo Kogyo managed better than the other companies in our sample to preserve its network of people and assets during the crisis, and simultaneously to shift them to new production.

At the other end of the spectrum lies British Leyland, which shrunk more than it shifted. It cut the size of its workforce by fifty-two percent during its crisis, but did not fundamentally alter its products, manufacturing processes, or organization. As we have seen, most of the assistance was diverted into payoffs. Neither the employees, suppliers, dealers, nor banks bore any special sacrifice. Most of the bailout amounted to a simple transfer by which British taxpayers compensated those who otherwise might have been burdened by the company's contraction.

III. Explanations

The discussion above has identified two related phenomena in the four crisis-ridden companies—shrinking and shifting. Once the company received extraordinary assistance, the pace of its shrinkage was linked both to the likelihood of continued political interference in financial administrators' efforts to return the company to solvency, and to the economy's overall ability to absorb idled resources. The extent to which the company shifted its resources to more profitable pursuits rather than simply let them flow out, however, seems to have been related to how tightly the extraordinary assistance was tied to company investments instead of payoffs to its constituents.

Interestingly, the two relationships appear to have moved in the opposite direction: the slower the pace of shrinkage, the smaller the proportion of resources ultimately shifted. British Leyland's overall pace of shrinkage while it received assistance was the slowest of our four examples, and it also shifted the least. Toyo Kogyo's pace of shrinkage during its crisis was faster than that of British Leyland, but it shifted the most. AEG-Telefunken and Chrysler were in the middle on both scales.

Explanations are not difficult to find. The Japanese economy was performing relatively well during this period. Its unemployment averaged under 2.5% of the labor force, and overall productivity was improving

89. Yamada Interview, *supra* note 28.

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3.8% a year.⁹⁰ So we might expect that such adjustments—substantial internal shifts of resources coupled with the rapid release of whatever marginal resources could not be used even if the shift were highly successful—would characterize many large companies. On the other hand, during British Leyland's crisis, the British economy was performing poorly, with unemployment averaging six percent of the labor force and creeping upward. Yearly productivity improvements averaged only about 0.1%.⁹¹ Under these circumstances rapid shrinkage was politically problematic, and shifts were far more difficult to negotiate because every major transaction was a zero-sum game.

It seems equally plausible, however, that cause and effect ran in the opposite direction. Perhaps one explanation for Japan's relatively low unemployment and high rates of productivity improvement during these tumultuous years of oil shocks, world recessions, and rapid technological changes was the capacity of its large manufacturing enterprises to respond very rapidly—in our parlance, to shrink quickly and shift substantially. And perhaps one explanation for Britain's relatively poor performance lay in the comparative inability of its large manufacturers to do the same. The United States and West Germany, whose economic performance during these years fell between the two poles, also occupied intermediate points in the relative responsiveness of their larger manufacturers to rapid economic change.

Viewed in this light, the important distinction among our examples concerns not so much the intensity of political demands to save jobs—the pressures were intense and the governments highly responsive in all four cases. Rather, the important distinction is how the companies, and the set of institutions of which they were a part, responded to these demands. Toyo Kogyo's response was to jettison quickly a relatively small number of jobs and to shift the rest. British Leyland's response was to jettison slowly many of its jobs. AEG and Chrysler each attempted some of both.

How can we account for these differences in the patterns of response? A rescue was organized in all four cases, but the rescues were substantially different. Key institutions—labor, finance, and government—assumed different sets of responsibilities and undertook them in different ways. These variations resulted from the formal laws and informal understandings which governed the relationships among key institutions. The following sections explore some of these differences and the effects they had on the nature of the bailout in each instance.

90. For an analysis of all four countries' economic performances over the past five years, see U.S. Dep't of Commerce, 10 INT'L ECON. INDICATORS (1984).

91. *Id.*

A. *Information and Control*

One important difference is found in the timeliness and accuracy of information received about the company's difficulties by those with sufficient resources or influence to effectuate a rescue. Presumably, the earlier, more reliable, and more detailed that information, the easier it was to set a new course by shifting resources. Information coming much later, or of poorer quality, impaired the ability of the rescuers to do very much other than preside over a gradual shrinkage.

In the Toyo Kogyo case, the Sumitomo Bank knew of the firm's problems almost at once. Toyo Kogyo had done well in 1973, but the rapid rise in oil prices during the year made 1974 a disaster, causing the company to post a loss of \$75 million. By October 1974, the bank had sent two of its senior officials over to Toyo Kogyo to take on financial management of the firm temporarily. These officials thereafter supplied the bank with highly detailed information about all aspects of the firm's problems, and paved the way for a larger rescue team which took over day-to-day management entirely.⁹²

It was somewhat more difficult for the Dresdner Bank to get timely and accurate information about AEG's problems. Although the bank's chief executive also served as director of AEG's supervisory board, the board was slow to obtain detailed information, largely because of the tensions between labor and management representatives on the board.⁹³ Losses mounted steadily for six years before they reached the crisis level of \$580 million in 1979, finally forcing Dresdner Bank's hand.

Chrysler's problems were even better hidden. Manufacturers Hanover Trust Co. received the same quarterly reports that investment analysts and shareholders received, but these merely summarized Chrysler's gradually worsening position, without explanation. Sometimes the figures masked reality. In 1978, for example, when slumping car sales began to push the company into the red and forced it to halt production at many plants and slash dividends by sixty percent, the company still managed to project a fourth-quarter profit. Thanks to a little-noticed actuarial adjustment, Chrysler merely changed the assumed rate of return on its employee pension portfolio to seven percent from six percent, reducing pension costs and adding about \$50 million to its profits.⁹⁴ Manufacturers Hanover did not receive even moderately accurate projections of the firm's earnings or explanations of its problems until the Treasury Department's auditors

92. Yamada Interview, *supra* note 28.

93. See *infra* text accompanying notes 106 and 107.

94. Wall St. J., June 20, 1980, at 1, col. 6.

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and research began to obtain better information as a condition for the loan guarantee.⁹⁵ By then, the crisis was well underway.

British Leyland is the extreme case. Although news that British Leyland had problems came relatively early, there was very little information about the problems themselves, or the prospects for solving them. When the firm went to the government at the end of 1974, its losses for the year were only \$46 million—small by comparison with AEG-Telefunken or Chrysler. BL's banks, which had just refused to provide the company with any more loans, knew only that the firm's cash position was deteriorating rapidly. The government thereupon appointed a special commission to investigate, but the resulting *Ryder Report* contained no detailed assessments or projections. Its authors had done little more than ask BL management what new strategies the firm would pursue if money were no object, and report the results back to the House of Commons.⁹⁶ Nor was the National Enterprise Board equipped to diagnose BL's disease and prescribe a remedy, since it dealt with BL's managers at arm's length. Moreover, although BL officials filed reports with the NEB, the NEB—in sharp contrast to Sumitomo Bank—had no staff with particular expertise in the automobile industry.

The four sets of rescuers also differed considerably in their ability to affect a change in management or impose a new direction on the firm. Both the Sumitomo Bank and Dresdner Bank took the initiative in removing top managers who had presided over the firms' deepening problems and found new managers to replace them. The Sumitomo Bank continued to maintain tight control over Toyo Kogyo's rescue; the Dresdner Bank had a less direct role. At British Leyland, the National Enterprise Board selected the company's chief executives, but had no direct role in managing the company; the banks played no part. In the Chrysler case, the government also initiated the change by making it clear to Chrysler's board of directors that a management change was a precondition for a loan guarantee. The government, however, had no direct role in selecting a successor or in managing the company. As with BL, the banks to which Chrysler was indebted played no part.

These differences are attributable largely to differences in the relationships between banks, companies, and governments in the four nations, a subject to which we now turn.

95. Manufacturers Hanover Interview, *supra* note 33.

96. See generally RYDER REPORT, *supra* note 16.

1. *Financial Linkages: Japan*

In Japan, the lead bank for a company plays a key role in that company's long-term development, as well as in the long-term development of other companies in the same industrial group. Banks are permitted to lend substantial portions of their capital to individual companies, and may also hold up to five percent of the outstanding shares of any company. Other companies within the industrial group also hold shares in the bank and in one another.⁹⁷ In 1975, at the start of Toyo Kogyo's crisis, the Sumitomo Bank was responsible for more than sixteen percent of Toyo Kogyo's accumulated debt and it held five percent of Toyo Kogyo's shares. Toyo Kogyo held three percent of the shares of the bank. Given these relationships, it is not surprising that Toyo Kogyo routinely shared confidential information with the bank, and that when the crisis occurred Kohei Matsuda, the company's president, put up only minor resistance to the bank's rapid takeover.

In addition to close relations to companies, Japanese banks are linked tightly to government agencies—the Ministry of Finance, the Ministry of International Trade and Industry, and the central bank. Banks are the primary intermediaries between savers and borrowers, but the banks must rely on the central bank for some of their capital. Because government officials set interest rates at the central bank lower than the demand for funds otherwise would dictate, the banks must depend on the discretion of the central bankers and government authorities for the amount of funds they receive. This “window guidance” makes bank officials particularly sensitive to the inclinations of policymakers and politicians.⁹⁸ In the Toyo Kogyo case it was clear that government officials were concerned about the firm's future and wanted to restore its competitiveness, but they also wanted to preserve jobs.

These two binding relationships—between the lead bank and its client companies on the one hand, and the lead bank and the government on the other—make the lead bank one of the major channels between government and individual companies in Japan. Rescues of companies in distress are timely and effective largely because of this deeply-entrenched public role of the lead bank. Commenting on the Sumitomo Bank's rescue of Toyo Kogyo, one of the bank executives who had temporarily managed the troubled firm explained:

97. See Anti-monopoly and Fair Trade Maintenance Act, art. 11 (Japan), reproduced in Z. KITAGAWA, *DOING BUSINESS IN JAPAN*, app. 7a-16 (1984).

98. See J. ZYSMAN, *GOVERNMENTS, MARKETS, AND GROWTH: FINANCIAL SYSTEMS AND THE POLITICS OF INDUSTRIAL CHANGE* 248-50 (1983).

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[I]n Japan, banks are private profit-making operations. But at the same time, banks have a social obligation to make sure that their clients are healthy. Had Sumitomo Bank merely tried to get its loan to Toyo Kogyo repaid, it might have succeeded by forcing the company into bankruptcy. But the bank would have been criticized by society. It would have gotten a reputation for being unreliable. One of the bank's goals is to avoid that kind of criticism.⁹⁹

2. *Financial Linkages: West Germany*

The relationship between banks and companies in West Germany is similar to that in Japan. West German banks exercise extraordinary control over company access to capital; there are few other institutions which channel savings to borrowers.¹⁰⁰ By law, the banks can represent shareholders who deposit their shares with the banks.¹⁰¹ Because only the banks are allowed to trade on the floor of the West German stock exchanges, and therefore have the best knowledge of stock performance, most shareholders take advantage of this service. In 1974, the latest date for which such data are available, West German banks held proxies for sixty-three percent of the shares of the nation's seventy-four largest publicly-held companies.¹⁰² Banks are also permitted to purchase directly up to 100% of the shares of a company,¹⁰³ although it is considered imprudent for them to invest substantial portions of their capital in any single company.

As a result of these linkages, the banks in West Germany control a majority of the shares of companies to which they lend money. In 1974, for example, banks were represented on practically all of the supervisory boards of the seventy-four largest companies in the nation, and bank representatives chaired half of them.¹⁰⁴ Control is further centralized in West Germany's three largest banks—the Deutsche, Commerz, and Dresdner—which in 1974 supplied two-thirds of the bankers chairing such supervisory boards and voted thirty-five percent of the outstanding shares of the largest companies.¹⁰⁵

The banks' control of AEG-Telefunken fits this pattern. At the height of the firm's crisis, the Dresdner Bank was its chief creditor; the bank also

99. Yamada Interview, *supra* note 28.

100. See J. CARRINGTON & G. EDWARDS, FINANCING INDUSTRIAL INVESTMENT 117, 120 (1979).

101. Aktiengesetz § 135, 1965 Bundesgesetzblatt [BGBl] I 1089 (W. Ger.).

102. SCHRIFTENREICHE DES BUNDESMINISTERIUMS DER FINANZEN, BERICHT DER STUDIENKOMMISSION, GRUNDSATZFRAGEN DER KREDITWIRTSCHAFT, heft 28 (1979).

103. Aktiengesetz § 135, 1965 BGBl I 1089 (W. Ger.).

104. SCHRIFTENREICHE DES BUNDESMINISTERIUMS DER FINANZEN, *supra* note 102, heft 28.

105. *Id.*

directly held more than eighteen percent of the company's outstanding shares. With the proxies of AEG shares deposited with the bank or lent to it by other banks, the Dresdner Bank effectively controlled a majority of the company's shares. This explains why Hans Friderichs, the bank's chief executive, also came to be the chairman of AEG's supervisory board. It also helps explain why the bank assumed responsibility for arranging first the "private" bailout of the firm, and then the public one: the bank simply had too much at stake in AEG to let the firm go under all at once.

In these respects, the relationship between the Dresdner Bank and AEG paralleled that between the Sumitomo Bank and Toyo Kogyo. There were important differences, however. The Dresdner Bank did not have access to the same quality of information about AEG that Sumitomo had about Toyo Kogyo, nor at quite such an early stage of the crisis. The Dresdner Bank could neither place bank officers in key positions within AEG, as Sumitomo had done with Toyo Kogyo, nor accomplish the dramatic changes that the Sumitomo Bank managed at Toyo Kogyo in a relatively short time.

The ability of Dresdner Bank to control outcomes at AEG was also compromised by divisions on AEG's supervisory board. As AEG's financial position deteriorated in the middle and late 1970's, its board was unable to agree on a diagnosis or a plan of action. Not trusting the bank representatives to act in the best interest of labor, the representatives of labor on the board withheld certain information in their possession.¹⁰⁶ Not trusting labor to maintain confidentiality, management and the bank representatives also withheld information.¹⁰⁷ As the crisis deepened in 1979, the board was deadlocked. The Dresdner Bank refused to seek assistance from the government because it feared that such a move would give labor a greater voice in the management of the company, and ultimately in the management of the economy. It therefore turned for help to other banks, industrial companies, and insurance companies, while labor simultaneously sought help from the government. Even by 1982, when the bank was forced to go to the government, it negotiated separately from labor. In short, the ongoing power struggle in which the Dresdner Bank found itself impaired its ability to manage AEG's rescue.

In addition, it is important to note that West German banks are not politically accountable for their major decisions¹⁰⁸ despite all their power over the economy. The Dresdner Bank thus never assumed the same pub-

106. Interview with an official of the Dresdner Bank (name withheld by request), in Cambridge, Mass. (Jan. 12, 1984) [hereinafter cited as Dresdner Interview].

107. *Id.*

108. See, e.g., J. ZYSMAN, *supra* note 98, at 260.

lic responsibilities for West German economic development that the Sumitomo Bank assumed for Japanese development. Unlike the Sumitomo Bank, the Dresdner Bank was not an agent of government policy.

3. *Financial Fragmentation: United States*

Banks in the United States maintain arm's-length relationships both with companies and with the government. This helps to explain why Chrysler's lead bank, Manufacturers Hanover, had neither early warning of Chrysler's problems, nor the ability to solve the problems even if it had received warning. The arm's length relationship between banks and companies is required by law. In general, financial institutions in the United States may not hold shares in separate business enterprises.¹⁰⁹ National banks, bank holding companies and insurance companies are typically permitted to engage (either directly or through a subsidiary) only in businesses bearing a close relationship to traditional banking or insurance functions.¹¹⁰ In addition, the Glass-Steagall Act limits the role of commercial banks in underwriting and purchasing securities and specifically prohibits them from making investments in corporate securities for their own account.¹¹¹ Further restrictions on bank investments were embodied in the Bank Holding Company Act, which was designed to extend the principle of separation of banking from commerce to entities that own or control banks.¹¹² Similar restrictions on investments by state chartered banks exist

109. The Bank Holding Company Act, 12 U.S.C. § 1843 (1982), generally prohibits bank holding companies from engaging in nonbank activities.

110. See, e.g., Bank Holding Company Act, 12 U.S.C. § 1843(c)(8) (1982) (a bank holding company may invest in a company which the Board of Governors of the Federal Reserve determines "to be so closely related to banking or managing or controlling banks as to be a proper incident thereto"); N.Y. BANKING LAW § 96.1 (McKinney 1971 & Supp. 1984) (banks may "exercise all such incidental powers as shall be necessary to carry on the business of banking"); N.Y. INS. LAW § 46-a1(a) (McKinney 1971 & Supp. 1984) (insurance companies may invest in subsidiaries engaged in insurance or investment related business); CONN. GEN. STAT. § 38-146a (1983) (Connecticut mutual life insurance companies can invest in subsidiaries engaged in insurance or investment-related business).

111. 12 U.S.C. § 24 (1982). Under 12 U.S.C. § 335, the provisions of 12 U.S.C. § 24 also apply to restrict the investment of state member banks of the Federal Reserve System.

112. Section 4(c)(5) of the Bank Holding Company Act (BHCA), 12 U.S.C. § 1843(c)(5) (1982), permits a bank holding company to invest in "shares which are of the kinds and amounts eligible for investment" by a national bank under 12 U.S.C. § 24 (thus embodying the limited exceptions to the Glass-Steagall Act). Section 4(c)(6) of the BHCA, 12 U.S.C. § 1843(c)(6) (1982), permits a holding company to own no more than five percent of the outstanding voting shares of any company. Although an equity investment of up to five percent might be insignificant, investments of five percent each by a number of bank holding companies could be substantial in the aggregate. However, there is a substantial risk that such joint investments of less than five percent each could be unprotected by § 4(c)(6). See 12 C.F.R. 225.137 (1984) ("the exemption was not intended to allow a group of holding companies, through concerted action, to engage in an activity as entrepreneurs"). Section 4(c)(2) of the BHCA provides an exemption to bank holding companies or any of their subsidiaries for shares acquired in satisfaction of "a debt previously contracted." 12 U.S.C. § 1843(c)(2) (1982). Unless such shares represent less than five percent of the total outstanding shares, they may only be held for a period of two years (which may be extended at the discretion of the Federal Reserve Board).

under various state laws.¹¹³ Although insurance companies are generally permitted to make equity investments under state laws, such laws frequently require the investments to be made in corporations with a specified level of financial performance and strength.¹¹⁴

In addition to these limitations on equity ownership, banks in the United States may not extend loans which exceed ten percent of the bank's capital to an individual company.¹¹⁵ Moreover, banks generally may not do business in more than one state.¹¹⁶ On the other hand, specialized investment banks are permitted to hold shares,¹¹⁷ but, because they are not allowed to accept deposits, they have comparatively few resources to invest. Such banks function primarily to maintain secondary markets for commercial paper and corporate bonds.

Most of these restrictions originated in the 1930's to help ensure bank solvency and credibility, and some are gradually succumbing to the forces of deregulation and competition.¹¹⁸ These restrictions have had the effect of fragmenting and decentralizing financial intermediaries in the United States, so that no large company is particularly dependent upon any single financial institution, or vice versa. Chrysler was indebted to more than 400 separate banks; it also had substantial amounts of commercial paper and corporate bonds outstanding. By the same token, even Manufacturers Hanover, Chrysler's chief lender, regarded Chrysler as but one of a large number of clients about whom the bank knew relatively little.¹¹⁹ The loan officer in charge of the Chrysler account had no particular knowledge about Chrysler or the automobile industry; indeed, his portfolio of ac-

113. For example, New York banks generally may not purchase the stock of other corporations. Although Section 97.5 of the New York Banking Law provides that a New York bank may acquire "[s]o much of the capital stock of any other corporation as may be specifically authorized by the laws of this state or by resolution of the banking board upon a three-fifths vote of all its members," the investments which are "specifically authorized" are not numerous. A provision similar to the exemption in 12 U.S.C. § 1843(e)(2) is also present in the New York statute, N.Y. BANKING LAW § 97.5 (McKinney 1971 & Supp. 1984).

114. McCarran-Ferguson Act, 15 U.S.C. § 1011 (1982) (states given authority to regulate the business of insurance). Under New York law, an insurance company may not invest in common stock unless the issuing institution earned enough in the aggregate to pay a dividend of four percent on all stocks and shares outstanding for each of the seven years preceding the acquisition by an insurer. N.Y. INS. LAW § 81(13)(a) (McKinney Supp. 1984). Various limitations are also placed on such equity investments in terms of a percentage of the insurer's total assets. See N.Y. INS. LAW § 81(13)(b) (McKinney Supp. 1984).

115. This restriction applies only to national banks. See 12 U.S.C. § 84(a)(2) (1982).

116. 12 U.S.C. § 36(c) (1982).

117. Banking Act of 1933, §§ 20-21, 12 U.S.C. §§ 78, 377, 378 (1982); see also 4 F. SOLOMON, W. SCHLICHTING, T. RICE & J. COOPER, BANKING LAW § 80.22(3) (1984) [hereinafter cited as F. SOLOMON]; Clark & Summers, *Judicial Interpretation of Glass Steagall: The Need for Legislative Action*, 97 BANKING L.J. 721 (1980).

118. See, e.g., *Nationwide Banking: Barriers Fall*, N.Y. Times, June 4, 1983, at 29, col. 3; *America's Debut in Offshore Banking*, N.Y. Times, Nov. 22, 1981, at F1, col. 2.

119. Interview with Manufacturers Hanover Trust Co. loan officer (name withheld by request), in New York City (Jan. 10, 1984).

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counts was arranged geographically, rather than by industrial sector.¹²⁰ He periodically reviewed Chrysler's balance sheets and income statements to assure that they technically conformed to bank credit requirements. He was not trained to analyze financial projections or strategic plans, even had Chrysler been willing to give them to him.¹²¹

Even if bank managers possessed the skills, knowledge, and authority needed to deal with problems such as those experienced by Chrysler, it was not clear that they would have wanted to become deeply involved in developing a solution. Financial institutions in the U.S. which wish to participate in the debtor's management risk creating a relationship that will cause them to be deemed "in control" of the debtor. This may subject them to substantial liability under United States bankruptcy, securities and tax laws.¹²² Even if a lender is not actually in control of a debtor, allegations that such control exists can result in expensive litigation.

In addition, corporate laws of various states draw a relatively sharp distinction between the fiduciary duties owed creditors and those owed shareholders.¹²³ Chrysler managers had a legal responsibility to act in the best interest of Chrysler shareholders, not in the best interest of the bank's shareholders.¹²⁴ Had the bank required as a condition of a loan that

120. *Id.*

121. *Id.*

122. Under the Bankruptcy Code, "insiders" are subject to possible recovery preferences during the one year period preceding the commencement of a bankruptcy case, while other persons are subject to such recoveries only during the ninety-day period preceding the commencement of a case. 11 U.S.C. § 547(b)(4) (1982). An "insider" is defined to include a director, officer, or person in control of the debtor. 11 U.S.C. § 101(25) (1982). Moreover, the bankruptcy court has the power to subordinate one claim to another on considerations of equity and fairness. 11 U.S.C. § 510(c) (1982). A creditor in control of a debtor can expect that it will be met with allegations that its claim should be equitably subordinated if not disallowed.

Although there is no specific statutory definition of "control" in either the Securities Act of 1933, 15 U.S.C. § 77b (1982), or the Securities Exchange Act of 1934, 15 U.S.C. § 78c (1982), the Securities and Exchange Commission broadly defines control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." 17 C.F.R. 230.405 (1984). Therefore, a creditor which directly participates in or selects management runs the risk of being considered to be in control of the debtor. *See, e.g., In re Falstaff Brewing Corp. Antitrust Litig.*, 441 F. Supp. 62 (E.D. Mo. 1977) (lender that controls the daily affairs of borrower corporation can be held liable for corporation's Securities Exchange Act of 1934 violations).

123. The fiduciary duty of corporate directors and officers to stockholders includes a duty to act loyally, in good faith, and without assuming any position in conflict with the interest of the corporation. 19 C.J.S. *Corporations* § 761 (1940). No such fiduciary duty automatically exists with respect to creditors; directors and officers are merely agents of the corporation. 19 C.J.S. *Corporations* § 837 (1940).

124. *See, e.g., Newman v. Forward Lands, Inc.*, 418 F.Supp. 135, 136 (E.D. Pa. 1976) (the directors "had a duty to exercise in managing [the company's] affairs, but the duty was owed only to the corporation itself and not to" those outside the corporation); *Rosebud Corp. v. Boggio*, 39 Colo. App. 95, 561 P.2d 367 (1977) (managers of solvent corporation are primarily responsible to the corporation, though managers of insolvent corporation may be trustees for the entity and for its creditors).

Chrysler change its management or take some other action that might harm Chrysler shareholders—for example, selling off a valuable property to pay off corporate debts—Chrysler's shareholders could have a right of action against the bank.¹²⁵

These fiduciary obligations obviously constrain the banks from asserting control over distressed companies. It is interesting to note that during the years immediately preceding Chrysler's crisis, the chairman of the board of Manufacturers Hanover, Gabriel Hauge, also was a member of Chrysler's board of directors—an interlocking relationship of the sort which flourished between Sumitomo Bank and Toyo Kogyo, and Dresdner Bank and AEG-Telefunken. Unlike the situations in Japan and West Germany, however, this relationship was purely cosmetic. It may have impressed a few shareholders or smaller creditors, but as a practical matter Hauge had to be careful not to pass information he learned at the Chrysler board meetings to the commercial loan department of the bank, lest he place himself in a conflict of interest and thereby invite a suit by Chrysler shareholders.¹²⁶

The U.S. government, like the West German government, has no particular substantive authority over the banks, although it closely regulates them to ensure solvency and prudence. The government collects a large amount of information about individual companies in tax filings, securities filings, reviews of regulatory compliance, and reviews of proposed mergers and acquisitions. Most of these data, however, are in the wrong form to provide adequate warning that a major company is in trouble, or are dispersed among so many agencies that they often cannot be reconstructed without contravening laws which protect confidentiality.¹²⁷ This inadequacy explains why, when Chrysler came to the White House seeking help, the Carter Administration had to commission a variety of studies by

125. See, e.g., *State Nat'l Bank of El Paso v. Farah Mfg. Co., Inc.*, 678 S.W.2d 661 (Tex. App. 1984) (creditor held liable to debtor for damages resulting from creditor's efforts to prevent one individual from becoming chief executive officer and to retain in his place management more sympathetic to the creditor's concerns); *Connor v. Great Western Sav. and Loan Ass'n*, 68 Cal.2d 850, 864-66, 447 P. 2d 609, 616-17, 73 Cal. Rptr. 369, 376-77 (1968) (lender became participant in home construction enterprise by entering business relationships with the developer as well as lending capital, and thus was liable to the home buyers for structural defects).

126. Interview with Paul Hunn, Vice-President, Manufacturers Hanover Trust Co., in Cambridge, Mass. (March 7, 1984) [hereinafter cited as Hunn Interview].

127. Most agencies forbid inter-agency and inter-governmental flow of information. For example, in the Tax Reform Act of 1976, Congress provided that all tax returns and information were confidential and, thus, not routinely subject to disclosure to federal or state agencies. 26 U.S.C. § 6103 (1982). Similarly, information gathered by the Federal Trade Commission is confidential and may be shared with other federal agencies only in disaggregated form, with limitations on the use of such data. 15 U.S.C. § 57b-2 (1982). The Bureau of the Census may not disseminate census data in any form whereby an individual establishment might be identified, nor use the data for other than statistical purposes. 13 U.S.C. § 9(a) (1982).

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private accountants, investment bankers, and management consultants in order to elicit useful information about the company's plight and future prospects, rather than rely on data already in the government's possession.

4. *Financial Fragmentation: Great Britain*

If anything, British banks are even further removed from the companies to which they lend money than are U.S. banks. The City of London, Britain's "Wall Street," is oriented to an international financial market in which capital is highly mobile. As a result, financial relationships are fragmented. Loans tend to be short-term (more than eighty percent are due to be paid within a year),¹²⁸ and British companies typically finance their expansion through retained earnings and new issues of stock.¹²⁹ In addition, the fiduciary obligations governing banks and company managers are at least as strict as those in the United States.¹³⁰ For these reasons, the banks play no significant role in monitoring or rescuing large firms in distress. British Leyland's major creditors had no inside information about the company's mounting problems, and no particular capacity to do anything about them.¹³¹

128. J. CARRINGTON & G. EDWARDS, *supra* note 100, at 129.

129. J. ZYSMAN, *supra* note 98, at 193.

130. For a comprehensive analysis of fiduciary duties in England, see H. SHELDON & P. FIDLER, *SHELDON & FIDLER'S PRACTICE AND LAW OF BANKING* 35-65 (11th ed. 1982).

131. Although the relationships between a troubled company and its bank, and the bank and the government, are more attenuated in Great Britain than in our other examples, the relationship between distressed companies and the government is closer. Britain is the only nation of the four to have embraced public ownership as a general solution to the problem of large companies in distress, or to have permanently created a special institution of government to oversee such rescues. Perhaps the two phenomena are related: with the banks unwilling to back up such companies or help oversee their revival, the burden has fallen entirely upon government to meet resulting political demands for special assistance.

The National Enterprise Board, which oversaw most of the rescue of British Leyland, was conceived as a kind of state "holding company" whose purpose, according to its guidelines, was to "combine the advantages of public sector financial resources and the private sector's entrepreneurial approach to decisionmaking." NATIONAL ENTERPRISE BOARD, ANNUAL REPORT AND ACCOUNTS 1977, at 56-59 (1978). Board members were appointed by the Secretary of State for Industry; the director and deputy of the board during this period were drawn from industry, and four of the nine part-time members were trade unionists. The board was authorized to make loans to troubled companies only at "commercial" rates of interest, and only to companies that eventually could become viable on their own. Lord Don Ryder, its first director, who presided over the initial stages of the British Leyland rescue, stated that "it is not part of NEB's policy to prop up non-viable companies simply to maintain jobs." NATIONAL ENTERPRISE BOARD, ANNUAL REPORT 3 (1976), *cited in* W. GRANT, *THE POLITICAL ECONOMY OF INDUSTRIAL POLICY* 106 n.13 (1982).

In addition, the NEB was not equipped to anticipate problem companies or to monitor and supervise the restructuring of the sort that a large company such as BL required. The Board had no particular knowledge of individual companies or industries; its relationship with BL, for example, was entirely by way of the chief executives whom the Board selected. The government could only approve or disapprove company decisions on the basis of limited financial data. Every request for funds or for additional funds, therefore, became a choice between acceding to the company or allowing it to fail. W. GRANT, *supra*, at 104-110.

B. *Sacrifice*

Even if a rescuer has early and reliable information about a company's growing problems and asserts managerial control over the company, the "rescue" still is more likely to be an orderly shrink than a substantial shift, unless the other participants cooperate. In particular, workers must be willing to accept lower pay at least for a time, and to shift to new jobs within the company. Lenders must maintain their outstanding loans even in the face of higher risks, and perhaps advance additional credit. Without these sacrifices, new funds from the rescuer merely preserve the status quo for a time—maintaining existing wages and commercial credit while the company gradually shrinks.

The four cases represent a spectrum of sacrifice, with Toyo Kogyo and British Leyland once again occupying the extremes. Toyo Kogyo workers accepted major pay cuts, and many of them agreed to transfer temporarily to automobile dealers hundreds of miles away from Hiroshima. Similarly, Toyo Kogyo's banks, insurance companies, and suppliers agreed to maintain loans or advance credit. On the other hand, British Leyland workers resisted pay cuts and changes in work rules and job classifications, while private lenders called in their loans and refused to make new ones. AEG and Chrysler lie in between: AEG's lenders sacrificed, but its workers balked at major reductions in wages and benefits; Chrysler's lenders and workers both sacrificed, but only to a limited extent. This section attempts to account for these differences in the degree of sacrifice parties were willing to undertake.

1. *Financial Interdependency*

One explanation is found in the structures of national financial markets. For the same reasons that lead banks in Japan and West Germany receive more timely and detailed information about their clients than "arm's-length" banks in the United States and Britain, they also are more committed to maintaining their clients. In these countries, even a gradual liquidation would be likely to impair the value of the bank's equity and jeopardize its major loans, both with the distressed company and also with a larger network of suppliers and industrial purchasers which depend on the company. These lead banks therefore are more likely to finance resource shifts than banks in the United States or Great Britain.

In addition, these lead banks are linked financially and strategically to other banks, insurance companies, and trade creditors. The lead banks, therefore, can facilitate the agreement of these other lenders to maintain their own outstanding loans to the troubled company, and even on occasion to provide new financing. These interdependent networks function as

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systems of mutual aid. Lenders, in effect, insure one another against relatively sudden market changes which might threaten their survival.

In 1975, at the start of Toyo Kogyo's crisis, the Sumitomo *keiretsu* as a whole held almost eleven percent of Toyo Kogyo's shares and Toyo Kogyo had considerable holdings in other group members. The Sumitomo Bank also held nine percent of the shares of C. Itoh, the trading company outside the group on which the bank later called to help Toyo Kogyo. In addition to this financial tie, several members of the Sumitomo *keiretsu* supplied parts to Toyo Kogyo, or had common technological needs and therefore were engaged in joint ventures or joint purchasing arrangements. These financial and strategic ties enabled the bank to spread the cost and risk of the Toyo Kogyo rescue among many cooperating institutions. They also enabled the bank to make credible guarantees about the company's survival and thereby reduce the perceived riskiness on new loans. Given all these interdependencies, the Sumitomo Bank's announcement that it would stand by Toyo Kogyo made other lenders more willing to maintain their outstanding loans and commercial credits with the company.¹³²

Like Sumitomo in the Toyo Kogyo case, the Dresdner Bank was able to call on other banks and insurance companies to help AEG. For some of these participants the stake was more direct: twenty four of these banks held almost fifty percent of the AEG's outstanding shares; the Deutsche Bank alone held nine percent. The Dresdner Bank could also count on the support of a small group of industrial companies. Although this group was not as formally organized and integrated as the Sumitomo Group, its ties were similarly strategic and financial. Through its close relationship with AEG, the Dresdner Bank gradually had developed expertise in the electronics and capital goods industries in which AEG competed; the bank therefore organized its industrial loan department along these sectors.¹³³ In this way, over time, many AEG suppliers and industrial purchasers became clients of the bank. These interdependencies were reinforced as the bank took equity positions in these companies.

There was no similar, mutually dependent network on which Chrysler or British Leyland could rely. As we have seen, British Leyland's banks backed out early in the crisis.¹³⁴ Chrysler's banks agreed to extend the maturity of some notes in 1980, and in 1981 they agreed to convert approximately one-third of the company's outstanding debt to equity and to write down another one-third. The banks, however, demanded full pay-

132. Yamada Interview, *supra* note 28; Maeda Interview, *supra* note 58.

133. Dresdner Interview, *supra* note 106.

134. See *supra* at 171.

ment on the final one-third, and throughout the crisis, they adamantly refused to extend new loans to the company. The few concessions they did make came largely as a result of pressure from the Treasury Department and the Federal Reserve Board.

To some extent, the comparative reticence of U.S. and British banks can be explained by differing auditing practices and financial regulations. Auditors and bank examiners in Japan and West Germany take a far more lenient view of non-performing loans than do their colleagues in the United States and Britain. In Japan and West Germany, debtors may violate loan covenants or miss interest payments without necessarily forcing the bank to write down the asset on its books. Because the debtor may well shift into a more profitable line of business, the loan is not necessarily considered to be riskier, or of lesser value, than it was before.¹³⁵ For the same reason, the bank also may advance new loans to such a company and carry the new loan as an asset.

In the United States and Britain, on the other hand, bank auditors and regulators are more concerned about the risk of inadequate capitalization. A bank typically is required to write down its non-performing loans;¹³⁶ it also may have to expand its loan-loss reserves in coming years. These items are charged off against earnings. If the distressed company subsequently repays the loan and any lost interest, these payments can be applied against whatever provisions have been made for the losses.¹³⁷ In the interim, however, the damage has already been done to the bank's reported profits, thereby impairing its ability to raise more capital. By the same token, new loans to a distressed company are scrutinized carefully; the bank probably would not be able to carry them as assets.

This cautious approach obviously makes banks more reluctant to accept temporary sacrifices. A Manufacturers Hanover vice president in charge of problem loans explained that the bank would never extend a new loan to a distressed company except as part of a plan to reduce the bank's overall embedded debt. Indeed, the bank followed this rule with respect to Chrysler and other banks took the same position.¹³⁸ Such a rule ultimately favors shrinkage over shifts.

Financial structures are only part of the story, of course. To understand why sacrifices were more widespread in Toyo Kogyo than in British Leyland—with AEG and Chrysler in between—we also need to examine the organization of labor.

135. Yamada Interview, *supra* note 28; Hunn Interview, *supra* note 126; *see also* Commercial Code, art. 281 (Japan), reproduced in Z. KITAGAWA, *supra* note 97, app. 5a-104.

136. *See* F. SOLOMON, *supra* note 117, at § 44.08(2).

137. Hunn Interview, *supra* note 126.

138. *Id.*

2. *Labor Interdependency*

By a variety of formal and informal rules, Japanese workers are tightly linked to their companies. The links are somewhat more attenuated in large West German companies. In the United States and Great Britain, such links are almost non-existent. These patterns are evident in the ways unions are organized, in the relations between unionized workers and managers, and in ways of providing job security and regulating wage differentials, among workers.

In each of the four countries, workers are organized at several levels. At the bottom are local shop-floor organizations, which are aggregated into company unions or affiliates, then into industry unions, and finally into multi-industry labor federations. The locus of control differs in each country, however. In Japan, company unions predominate; most of the important decisions about wages and working-conditions are made at this level.¹³⁹ Company unions also are important in West Germany.¹⁴⁰ Unlike their Japanese counterparts, West German workers also participate through their unions in national negotiations over wages and macroeconomic policies.¹⁴¹ Company unions are less important in the United States and Great Britain. In the United States, most bargaining occurs at the level of the industry union.¹⁴² In Britain, bargaining occurs both at the shop floor and at the industry level.¹⁴³

Formal relations between managers and unionized workers within the company are structured quite differently in the four countries. In most large Japanese companies there is no sharp distinction between supervisors and blue-collar workers. Japanese companies typically employ elaborate systems of joint consultation through which confidential management information is shared with lower-level employees. Japanese company unions include many white-collar supervisors, and the links between management and labor are reinforced by the fact that many company directors were once union leaders.¹⁴⁴ In West Germany, distinctions between production workers and supervisors are more clearly drawn, yet there exist a variety of consultative mechanisms. By law, union representatives occupy

139. See, e.g., W. GOULD, *JAPAN'S RESHAPING OF AMERICAN LABOR LAW* 2 (1984); R. CLARK, *THE JAPANESE COMPANY* 50-55, 98-139 (1979).

140. E. CULLINGFORD, *TRADE UNIONS IN WEST GERMANY* 22 (1976); C. HANSON, S. JACKSON & D. MILLER, *THE CLOSED SHOP: A COMPARATIVE STUDY IN PUBLIC POLICY AND TRADE UNION SECURITY IN BRITAIN, THE USA AND WEST GERMANY* 191 (1982).

141. E. CULLINGFORD, *supra* note 140, at 17, 21.

142. See E. SMITH, *TRADE UNIONS IN THE DEVELOPED ECONOMIES* 169-70, 172-73 (1981).

143. See K. COATES & T. TOPHAM, *TRADE UNIONS IN BRITAIN* 166-67 (1980).

144. W. GOULD, *supra* note 139, at 4 ("of 313 major Japanese companies . . . 74.1 percent had at least one executive director who once had served as a labor union leader"). See also R. CLARK, *supra* note 139, at 109.

one-third to one-half of the seats on company supervisory boards, which have responsibility for major decisions affecting the company.¹⁴⁵ In the United States and Great Britain, on the other hand, managers and workers are sharply separated.

The National Labor Relations Act (NLRA), for example, presumes a fundamental conflict between managers and employees. Section 8(a)(2) makes it an unfair labor practice for employers to "dominate or interfere with the formation or administration of any labor organization or contribute financial or other support to it."¹⁴⁶ This provision has been construed broadly to bar management from supporting certain formal mechanisms of worker participation.¹⁴⁷ By the same token, supervisory employees are excluded from the provisions of the NLRA on the theory that the supervisor-employee relationship is necessarily adversarial and supervisors represent management; union membership, it is assumed, would involve them in a conflict of interest.¹⁴⁸ An American employer is under no obligation to open its financial records to its unions unless the company specifically pleads an inability to pay during collective bargaining.¹⁴⁹ Nor do employers have a duty to bargain about management decisions to close part of an operation.¹⁵⁰ The cumulative effect of these rules is to maintain an arm's length, adversarial relationship between management and employees.

Like American labor law, British labor law seems to presume a fundamental tension and separation between management and labor. For example, although British employers are obligated to disclose to the trade unions information without which the union representatives' collective bargaining efforts would be severely hampered,¹⁵¹ this obligation is subject

145. Betriebsverfassungsgesetz, 1952 BGBl I 681 (W. Ger.); Mitbestimmungsgesetz, 1976 BGBl I 1153 (W. Ger.).

146. See 29 U.S.C. § 158(a)(2) (1982).

147. See, e.g., *Homemaker Shops, Inc.*, 261 N.L.R.B. 441 (1982); *Kaiser Foundation Hospitals, Inc.*, 223 N.L.R.B. 322 (1976); *Midwest Piping and Supply Co.*, 63 N.L.R.B. 1060 (1945). When the United Auto Workers' president, Douglas Fraser, took a place on Chrysler's board of directors as a condition of union cooperation with the troubled company, the general counsel of the National Labor Relations Board declined to issue a complaint. The general counsel did so largely because the appointment created no financial ties between the company and the union. See N.L.R.B. Advice Memorandum, Case 7-CB-4815 (Oct. 22, 1980).

148. Justice Douglas' dissenting opinion in *Packard Motor Co. v. NLRB*, 330 U.S. 485 (1947), appears to have formed the rationale for the exclusion of supervisors under the 1947 Taft-Hartley amendments to the NLRA. In that case, Douglas argued that foremen should not be included as "employees" because a foreman's act—if attributable to management—might be an unfair labor practice, although—if the foreman were characterized as an "employee"—management would not be similarly liable. See *id.* at 496-497 (Douglas, J., dissenting).

149. *NLRB v. Truitt Mfg. Co.*, 351 U.S. 149 (1956).

150. *First Nat'l Maintenance Corp. v. NLRB*, 452 U.S. 666 (1981).

151. Employment Protection Act, 1975, ch. 71, §§ 17-21.

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to numerous qualifications and exceptions.¹⁵² The ability of workers to obtain data from management is further compromised—and, thus, the separation between workers and management is preserved—by the uncertainty of the procedures for enforcing whatever obligations do exist.¹⁵³ British employers are required to give trade unions advance notice of and the reasons for plant closings; however, they, like their American counterparts, are under no affirmative duty to bargain over such managerial decisions.¹⁵⁴

Finally, important differences also exist among these four countries in ways of providing job security and regulating wage differentials among workers. In Japan, employees of most large companies are hired directly from high school and expect to remain with the company until retirement; their wages and benefits depend largely on their age.¹⁵⁵ In West Germany job security is built into most labor contracts within large firms, as are generous severance payments in the event of necessary layoffs. Wage and benefit levels rise with the number of years the employee has served. In both West Germany and Japan, employers are required to provide employees with at least one month's advance notice of a plant shutdown.¹⁵⁶ In addition, employees have substantial rights in the event of an employer's insolvency: In West Germany, employees have a priority in bankruptcy, entitling them to sixty-eight percent average pay for one year; in Japan, they receive full wages for two years and eighty percent of the first three months' salary is provided by the state.¹⁵⁷

In the United States and Great Britain, job security and relative wages have been more closely linked to job classifications, work rules, and seniority; rights and benefits vary with the category in which a worker is classified. Particularly in the United States, income-security provisions have substituted for job security. The government administers unemploy-

152. Employment Protection Act, 1975, ch. 71, § 18. One of these exceptions excuses the employer from disclosure "where the compilation or assembly [of the requested information] would involve an amount of work or expenditure out of useful proportion to the value of the information in the conduct of collective bargaining." Employment Protection Act, 1975, ch. 71, § 18(2)(b).

153. See P. DAVIES & M. FREEDLAND, *LABOUR LAW: TEXT AND MATERIALS* 154 (1979); see also *Civil Service Union v. Central Arbitration Committee*, [1980] *INDUS. REL. L. REP.* 274 (giving a broad reading to the exceptions to the disclosure requirement).

154. The elimination of jobs through plant closings in England is governed by the Redundancy Payments Act of 1965, codified in the Employment Protection Consolidation Act, 1978, ch. 44, §§ 81-92. The Redundancy Payments Act was designed to increase managerial freedom in the elimination of jobs, by providing lump sum payments to workers to make the dismissals more palatable. P. DAVIES & M. FREEDLAND, *supra* note 153, at 166. Although constraints on managerial discretion were imposed in 1975, see Employment Protection Act, 1975, ch. 71, §§ 99-107, British managers remain free of the duty to bargain over plant closings.

155. W. GOULD, *supra* note 139, at 1-11.

156. See generally I. MAGAZINER & R. REICH, *MINDING AMERICA'S BUSINESS* 143-54 (1983).

157. *Id.*

ment insurance, which pays approximately sixty percent of previous wages.¹⁵⁸ In many industries these benefits have been supplemented by unemployment benefits built into wage contracts.¹⁵⁹ If the company cannot then offer "suitable employment," workers who are at least forty-five years old can collect regular pensions, plus \$400 monthly supplements until they become eligible for Social Security.

These different patterns of organization presumably influence workers' willingness to sacrifice in order to help a distressed company shift. Such shifts require flexibility in wages, benefits, and work responsibilities as alternatives to layoffs. Shifts also require external *inflexibility*—meaning that employees tend not to move between firms, but to remain with the same firm during the course of their career. This combination results in a great deal of mutual dependence between the company and the employee; both sides can draw upon a reservoir of trust and simultaneously rely on the discipline of future dealings. In consequence, unionized workers will be more willing to reduce wages and shift jobs during bad times than they would be otherwise.¹⁶⁰

Japan's system of company negotiations, combined with lifetime job security (in the largest firms) and age-based wages, is the most internally flexible of the four. When a Japanese company suddenly begins to lose money, it can quickly reduce its workers' wages and benefits, and shift job responsibilities. The Japanese system is also externally rigid: with lifetime employment as the norm, it is difficult for a worker to leave one large company and find employment with another. Like those of the lead banks, workers' fates are linked to that of the company. Toyo Kogyo's company union accepted pay raises lower than those received by workers

158. Unemployment insurance is administered jointly by the federal and state governments. Because the states administer the programs—setting eligibility requirements and compensation rates—the benefits paid may vary from state to state. Most states pay unemployment benefits at a rate equal to about sixty percent of a worker's salary prior to loss of employment, subject to certain limits. See, e.g., CONN. GEN. STAT. § 31-231a (1983); MICH. COMP. LAWS § 421.27(b)(1) (West Supp. 1984). The states collect taxes to pay unemployment benefits; these taxes are then paid into the federal government's Unemployment Trust Fund, from which the states are reimbursed for their expenditures. 42 U.S.C. § 1104 (1982). The federal government also disburses funds to the states to help pay the costs of administering unemployment benefit programs. 42 U.S.C. §§ 501-503 (1982).

159. In steel, aluminum, and canmaking, for example, workers with twenty years of service are guaranteed supplemental unemployment benefit (SUB) payments for two years, even if the union's own SUB funds are exhausted.

160. A moment's reflection will suggest how this relationship works. Suppose that a firm's managers contend that demand has declined and that workers therefore should reduce their wages. If the workers agree, the firm can have the same work as before but at a lower cost. But why should the workers believe the managers? They might believe them if they had built up a long-term relationship of trust and confidence, and the managers had shared company data with the union. But if the workers did not believe the claim, they could reduce the rewards to misrepresentation by refusing to cut their wages and forcing the firm to reduce its wage bill by cutting employment instead. For a general treatment of this subject, see Goldberg, *Relational Exchange: Economics and Complex Contracts*, 23 AM. BEHAV. SCI. 347 (1980).

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at other automobile companies and agreed to the transfer of 5000 workers to Toyo Kogyo dealers.

AEG's workers were less inclined to accept wage and benefit reductions. In West Germany, national labor negotiations may have reduced the flexibility of the company union. Officials at IG Metall, the national union that represented many of AEG's workers, were concerned that any concession at the company level might strengthen the hand of management nationally, not only with regard to wages and benefits of workers in other companies but also with regard to larger questions about the role of financial institutions in shaping economic development. AEG's workers had not participated in planning either the initial private rescue or the subsequent federal loan guarantee; the unions viewed both actions as disturbing precedents.

Chrysler's workers resisted wage cuts even more adamantly. The United Auto Workers did not want to depart from "pattern bargaining" in which wages and benefits are established for the entire industry. Nor was the union willing to give up work rules and job classifications, a move which would have permitted Chrysler management to shift workers to other responsibilities. Under the pressure of the Loan Guarantee Board, the union ultimately acceded to wage cuts in 1981, but only after tens of thousands of Chrysler workers already had been laid off.

Indeed, at no point in Chrysler's crisis did the union express a willingness to exchange wage concessions for job guarantees. The union seniority system may have been partly to blame for this, since the axe would fall on younger workers with less influence in the union. The majority of union members who voted on wage concessions knew that they were less likely to be laid off. This dynamic was most apparent in the fall of 1982, when Chrysler's workers were offered a no-raise, no-layoff contract. Fifty thousand Chrysler workers, including 45,000 still on the job and 5000 most recently laid off, were entitled to vote; a majority of them wanted pay raises. But 42,000 Chrysler workers were not allowed to make this choice between pay raises and job security. This group had been laid off for so long that they had lost their union voting rights. Had they voted, the results might have gone the other way, and many of these laid-off workers might have gotten their jobs back.

Workers at British Leyland were the least cooperative of all. Many of their disputes were not with BL management, but with other workers. With seventeen different unions arranged into 246 bargaining units, and an elaborate system of work rules and job classifications, every negotiation over wages and benefits for one group potentially altered the relative positions of every other group. The firm was wracked by disputes over union jurisdictions and pay differentials. Shop stewards vied for control. With so

many groups and individuals competing for leadership and influence, none could risk appearing to concede too much. In the end, most of the rescue money went to maintaining wages and providing lump-sum severance payments. Shrinking was far easier to accomplish than shifting.

Conclusion

The broader lessons that emerge from this study must be stated with the tentativeness they deserve. We have, after all, investigated only four cases, and explored only some of the plausible explanations for their patterns and outcomes. Nevertheless certain conclusions seem warranted.

First, the cases suggest that these sorts of large manufacturing enterprises are *more* than mere productive enterprises. They are also the centers of vast social and economic networks of suppliers, dealers, financial institutions, employees, and service industries. They anchor communities, define relationships, and structure social obligations. How these companies respond to crisis is therefore intimately conditioned by, and profoundly affects, the way these social systems respond. When large companies that employ substantial portions of a region's workforce begin to falter, political pressures invariably mount to "save jobs." Even if politics did not intercede initially, rapid dissolution of such companies might so disrupt social and economic life that governments and other institutions would be compelled to respond. The fact that they did respond in the four cases thus is less interesting than is the fact that they responded in very different ways.

Second, the responses can be arranged along a continuum. Some responses merely slow down the company's inevitable shrinkage. Other responses help the company to shift its resources internally to more profitable pursuits. We have looked at four examples. At the extremes, Toyo Kogyo quickly jettisoned a relatively small number of its jobs and shifted the rest; British Leyland slowly jettisoned most of its jobs and shifted comparatively few. Yet the British government intervened far more directly to save British Leyland jobs—effectively nationalizing the company—than did the Japanese government to save Toyo Kogyo jobs. Chrysler and AEG both lie midway on this continuum; both companies shrunk considerably after they were "rescued," although the Chrysler and the AEG loan guarantees also were premised on "saving jobs."

Third, the pattern of response seems related to the laws and detailed understandings which shape relationships between management, finance, and labor. There are other possible explanations, of course. Some have to do with the overall pace of economic activity surrounding these companies. Presumably shifts are easier to negotiate when the economy is expanding

and all participants can anticipate a larger income in the future. Culture also obviously plays a part; shifts are probably easier to arrange if people think of themselves more as group members—as in Japan—than as isolated individuals—as in the United States.

Between economics and culture, however, lies a detailed set of laws, regulations, and social norms which frame institutional relationships. These formal and informal rules both establish and represent responsibilities. They define institutional loyalties and shape patterns of negotiation among different groups of people. They thereby give rise to different types of transactions—some between parties that perceive their dealings to be only temporary and convenient; others, between parties whose ties to one another arise from perceived mutual dependencies stretching over long periods of time.

At one extreme we find companies which are tied to lead banks, and through the lead banks to other financial and industrial units, and regional and national governments. This network functions as a system of early warning and mutual aid. It insures against unexpected changes in the market, helping companies restructure themselves by shifting their resources internally at the first sign of trouble. The corresponding organization of labor is internally flexible, but externally inflexible. Although wages, benefits, and responsibilities can vary significantly within the company from one period to the next, employees find it relatively difficult to leave one company and obtain a new job at another. Employees' fates are as inextricably linked to the fate of the company as is the fate of the lead bank. This overall organization of finance and labor, typified by the case of Toyo Kogyo, strongly favors shifts over shrinkage, internal over external redeployment.

At the other extreme, we find companies which have no special ties to any particular financial institution, and financial institutions which are similarly fragmented and distanced from one another, from other companies, and from governments. Most of the financial transactions in this system are at arm's length; parties deal with one another on the basis of information available to them at the time and do not necessarily assume repeated dealings in the future. Each separate company or institution takes responsibility only for its own profitability. The corresponding organization of labor is internally inflexible, but externally flexible. Wages, benefits, and responsibilities do not vary significantly within the company from one period to the next, but employees find it relatively easy to leave the company. Management and labor deal at arm's length, because they are presumed to have conflicting agendas. As a result, neither employees nor financial institutions are especially dependent on the fate of a particular firm. Furthermore, neither can draw upon a reservoir of trust or rely

on the discipline of future dealings. This overall organization of finance and labor, typified by the case of British Leyland, favors shrinkage over shifts, external over internal redeployment.

Fourth, the government's role in rescuing large failing companies is likely to be far more visible and targeted when management, finance, and labor deal with each other at arm's length than when these groups are more tightly linked. When tightly linked to the firm, both financial and labor organizations are likely to be actively involved in responding to the crisis. Government therefore can do its work indirectly through these mediating groups. It can act on behalf of affected communities merely by supporting the financial institutions or the labor organizations which already have a stake. In contrast, when they are at arm's length from the firm, neither financial nor labor organizations are necessarily involved in the crisis. Much of the real burden of redeployment therefore falls on individuals, some of whom have no direct contractual relationship with the firm, and on local governments and relief organizations. These individuals and institutions in turn make political demands for direct government intervention to save jobs and communities. The irony, as the BL case reveals, is that government is able to do little more than slow the pace of shrinkage without the active cooperation of finance and labor.

Finally, the analysis suggests that the practical question in these circumstances is not whether the government should intervene to "save jobs," but how it might intervene to preserve social networks. The answer to *that* question has a great deal to do with how finance and labor are organized. There are some reasons why internal redeployment might be preferable to external for very large companies whose activities and employment is concentrated in certain regions. If internal redeployment is preferred, then centralized planning boards or national development banks, as have been suggested by some proponents of "industrial policy,"¹⁶¹ may be less useful than changes in the detailed rules and understandings by which financial institutions and labor organizations undertake their day-to-day responsibilities—changes which strengthen the bonds between the company's workers, managers, and financial institutions.

161. See, e.g., Eizenstat, *supra* note 5, at 49; Weil, *supra* note 5, at 981.