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Stimulate Car Buyers, Not Car Makers. Robert Hahn and Peter Passell. November 2008.

Should Uncle Sam do whatever is necessary to prevent General Motors, Ford and Chrysler from bankruptcy? If these were normal times, we suspect that most mainstream economists (and many mainstream legislators) would be inclined to let their stockholders, creditors and unions suffer the consequences of decades of myopic decisions. But with financial markets still in turmoil and the economy on the cusp of a nasty recession, these are hardly normal times. In any event, the metaphoric train has already left the station: Congress and the president-elect are committed to spending billions to keep the Big Three afloat.

What's not been decided, however, is how that money should be spent. And here, we think a change in perspective could spare the nation a lot of grief down the road. Rather than subsidizing the automakers directly (and almost inevitably sucking Washington in their management), why not give Americans the financial incentive to accelerate purchases of cars and light trucks? That way has its own drawbacks, of course: if cars, why not pizzas or lawn furniture? But the consumer-subsidy approach would be a less wasteful route to the desired end, as well as one that would leave a less toxic legacy of market intervention once the economy has recovered.

While the nature of the bailout is still on the drawing boards, all signs point to loan guarantees conditioned on concessions from the stakeholders – perhaps cuts in union and white collar compensation, surely restructured bank debt, maybe a shotgun wedding between Chrysler and GM. This would keep the industry alive and most of its workers employed for a while. And who can really say – this time, Detroit might deliver on the hoary promise that carmakers have really, truly figured out how to compete with the best from Asia and Europe.

However, even if the industry recovers with a lot of help from its friends, the price will be high. At best, the arrangement will tighten the all-too-cozy relationship between Washington and Detroit in matters of technology, pensions, fuel efficiency and environmental regulation, as well as lowering the political barriers to bailouts of equally worthy industries in distress. At worst, it will suck the taxpayers into the next automobile crisis and the next – after all, there will always be an adequate political rationale for giving this iconic industry the benefit of a doubt.

So what is the (realistic) alternative? A big fiscal stimulus package for fighting the recession – some combination of tax cuts, extended unemployment compensation, infrastructure grants and assistance to states – is coming soon. Why not repackage the auto industry bailout as a consumer stimulus plan? In particular, why not offer eye-popping rebates – say, $3,000 – for a limited time to buyers of cars and light trucks? As a matter of politics and economic justice, it would probably make sense to phase out the rebates for vehicles costing more than, say, $25,000, and to eliminate them entirely for those selling for more than $30,000. And as a matter of treaty obligation, it wouldn't do to discriminate

against foreign makes – besides, these days most "foreign" cars are made in places like Marysville Ohio, Claycomo Missouri, and Canton Mississippi.

The benefits would go to a combination of car buyers, state tax collectors, car dealers and car companies – and in proportions that economists couldn't predict with much accuracy. But it is a fair bet that most of the money would be quickly recycled in the form of demand for everything from auto parts to car mechanics' salaries to the aforementioned lawn furniture – just what you want to happen to climb out of a recession. And the size of the stimulus would be substantial. If, say, 12 million non-luxury vehicles were sold in the next year – similar to 2007 – the rebates would total $36 billion. Of that sum, about one-half would go for cars built by the Big Three. However, about 80 percent could be expected to be spent on vehicles manufactured in North America.

What about the people who can't afford new cars? Many of them would benefit anyway because the glut of trade-ins would reduce the cost of used cars. What about the U.S. tax dollars that would end up in the pockets of workers and shareholders in, say, Korea or Germany? In a globally integrated economy, a portion of any fiscal stimulus inevitably leaks abroad. Besides, we would like to believe that what were called "beggar-thy-neighbor" policies during the Great Depression are now widely viewed with the distaste they deserve.

Some of the details could prove to be more than loose ends. For example, the rebates would have to be phased out so that sales didn't drop off a cliff the day after the deadline. More generally, it is far from clear that it ever good policy to focus government largesse on one industry (rather than all) during hard times. But the question is no longer whether the federal government will come to the aid the auto industry. Wouldn't it be nice to manage the task with maximum benefit to middle-income Americans -- and minimal micromanagement by Washington?

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