Ford and GM debt reduced to junk bond status

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If one had to select the three most powerful symbols of the dominance of American industrial capitalism in the twentieth century it would be hard to go past Ford, General Motors and International Business Machines (IBM).

Ford pioneered the system of assembly-line production, which became the basis for the expansion of American industry in the 1920s and then laid the foundations for the longest period of growth in the world economy during the post-war boom.

General Motors became the largest manufacturing company in the world, with its multi-divisional system of management forming the standard for large-scale corporate organisation.

IBM was at the centre of the rise of the computer industry after World War II. Indeed, so great was its supremacy that it was virtually identified with it. When Stanley Kubrick made the movie *2001: A Space Odyssey* in 1968 he could think of no better way to devise a name for the all-powerful supercomputer, HAL, than to move back one letter in the alphabet from IBM.

Now these three giants of twentieth century capitalism confront a crisis, one that signifies not just their own decline but more broadly the decay of American capitalism as a whole.

Last week the credit-rating agency Standard & Poor's (S&P) announced it was reducing the corporate debt of both Ford and General Motors to junk bond status. IBM, after earlier selling off its personal computer division to a Chinese company, unveiled a "restructuring" program including a pre-tax write-off of between $1.3 billion and $1.7 billion and job cuts of between 10,000 and 13,000.

While the downgrading of Ford and GM had been expected, the severity of the cut, especially in the case of GM, which went down two grades, sent a shiver through credit markets. Altogether the amount of debt affected is $450 billion.

Announcing the GM cut, the S&P statement said the "downgrade to non-investment grade reflects our conclusion that management's strategies may be ineffective in addressing GM's competitive advantage". On Ford, the S&P statement said there was "scepticism about whether management's strategies will be sufficient to counteract mounting competitive challenges".

S&P said its outlook for GM was "negative", meaning that its rating could be downgraded further. The most immediate concern was that GM's sports utility vehicles (SUVs), on which the company has been heavily dependent, would not be as profitable in the future as in recent years. "Recently ... sales of its midsize and large SUVs have plummeted, and industry wide demand has evidently stalled, partly because of high gas prices. Also, competition has intensified due to a proliferation of new SUVs."

The S&P statement warned that even with "extensive efforts to renew its products, GM continues to lose market share in North America, despite an aggressive pricing strategy—and we believe the company's reliance on discounts has itself been detrimental to its brand equity. In addition, it is questionable whether GM's relative competitive standing had improved as a result of extensive cost-cutting in its North American operations." While GM had downsized its operations and curtailed excess production capacity, its profits were still being undermined because of the steady loss of market share.

The same problem is afflicting Ford. Even though the overall American vehicle market has continued to expand, the share of the two Detroit corporations has fallen. In April, while the market for light vehicles increased by 1.8 percent to 1.5 million, GM's sales dropped by 7.7 percent and Ford's by nearly 5 percent. GM's market share fell from 28 percent to 25.4 percent and Ford's from 19.8 percent to 18.4 percent.

International operations are not easing the domestic problems. GM's European operations have been running at a loss since 1999 and losses there this year are expected to be substantial. GM has been making healthy profits in China but that market is starting to weaken and there is increased competition.

The decline in market share has had a severe impact on profits. GM lost $1.1 billion for the March quarter, and announced it would not make projections for the rest of the year. While Ford's profit for the quarter was $1.2 billion, this was a 38 percent drop on last year's results.

Pointing to what it called the "precipitous" fall in GM's earnings in the recent period and the "alarming" first quarter loss, the S&P statement said profitability "could remain poor for the rest of the year, and prospects for a return to adequate profitability in the next few years are becoming increasingly uncertain". While GM had substantial cash reserves, "its ability to withstand persistent financial performance is not unlimited". In other words, if present trends continue—and the drain on cash-flow is expected to be "in excess of $5 billion this year"—GM will go bankrupt.

At present, the parent company is being sustained by its financial arm, General Motors Acceptance Corporation (GMAC). In terms of the contribution to profits, GM passed some years ago from being an industrial company with a financial arm, to an industrial offshoot of a finance company. In 2004, GMAC made $2.9 billion of the group's total net profits of $3.6 billion. Ford's profits of $35 billion were also largely attributable to Ford Credit. However, with interest rates in the US on the rise, financial profits could start to fall as consumers cut back on borrowings.

Along with all other financial analysts, S&P pointed to GM's "burdensome post-retirement benefit obligations" as a major drain on profits. The company's unfunded retiree medical liability, it noted, increased to $61 billion at the end of last year, up from "the already massive $57 billion" at the end of 2003. And these obligations "could become even more onerous". If GM were able to find some way to "roll back its health insurance benefits" then it could reduce a significant competitive disadvantage.

The *Economist's* report on the Ford and GM downgrade was headlined "Two piles of junk?" It noted that Ford's unfunded pension liability stood at $12.3 billion for the end of 2004 while GM's legacy costs, which accounted for 2.3 percent of revenue in 1999, are expected to rise to 5 percent this year. While both firms have substantial cash flows, the article continued, "it remains to be seen how long both firms can remain solvent if their core operations continue to bleed money and their legacy costs continue to grow. Bankruptcy no longer seems far fetched." In fact, both Ford and GM may embrace it as a way of slashing health-care and pension liabilities.

Another outcome of the crisis will be increased pressure on the US administration to take punitive action against rival firms. According to a report in Saturday's *Financial Times* (FT): "US carmakers are using growing congressional anger over the weak Chinese renminbi to boost pressure on Japan and South Korea to revalue their currencies as well, a move they hope could ease competitive pressures on the beleaguered US industry." The FT cited a paper prepared by the US car companies, which complained that Japan's weak yen policy "has given its exporters a huge subsidy and competitive advantage in the US market, causing significant harm to US manufacturers".

Fifty years ago during Senate hearings, Charles Wilson, the GM chairman, famously claimed that "What's good for General Motors is good for the rest of America." Those remarks came in the midst of the post-war boom, when American capitalism was the industrial powerhouse of the world, providing increased living standards for the working class at home and offering concessions to the other major capitalist powers. No longer.

Now Ford and GM are beset by international competitors, their industrial strength has severely eroded and they face a deepening crisis of profitability. Their policies reflect those of the Bush administration and American imperialism as a whole—stepped up pressure against foreign rivals combined with deeper attacks on the living standards of the working class.