

# SUPPLIER SHOCK: EXPLAINED IN SIMPLE TERMS FOR MATT YGLESIAS

Big Media Matt has apparently no more hung out around the auto industry than he has tasted a quality turkey. He's struggling to understand why Ford would lobby Congress to help its competitor GM stay in business.

The key—as we've discussed here—is that if GM went under, it would bankrupt some suppliers. And the supply chain for automobile manufacturing in the US is so intertwined, this would create supply problems for the other manufacturers—not just Ford, but also the international manufacturers.

Here's how the Center for Automotive Research (a wonky organization of the sort Matt likes that is cited in just about every article on the crisis) describes what would happen if all three manufacturers had a major contraction.

We assume that domestic production by international automakers in the United States would be seriously affected by a major contraction of the Detroit Three automakers for at least a period of one year due to the high likelihood of many U.S. supplier company insolvencies. In fact, we assume in our 100 percent contraction scenario that not only does domestic production by the Detroit companies fall to zero in the first year, but that domestic production (in the U.S.) by the international producers also falls to zero. That is because we expect a major wave in supplier bankruptcies or a "supplier shock." The collapse of a domestic market for suppliers coupled with the reality that few auto suppliers serve export markets

would result in manufacturing utilization rates below 50 percent, forcing suppliers to restructure or liquidate. **The scale of the contraction of the Detroit Three would overwhelm any attempt by the international producers to keep their existing suppliers in business or to find alternative suppliers,** here or elsewhere. U.S. consumers would be forced to rely on only imported vehicles as a source of new vehicle purchases in the first year. [my emphasis]

In other words, Big Two and a Half bankruptcies would also bankrupt suppliers that got roughly 50% of their business from the Big Two and a Half. And if the foreign manufacturers relied on any one of those suppliers, they would start running out of parts and have to idle their assembly plants.

Now, that's the most extreme scenario, in which Ford goes under with GM and Chrysler. But as CAR points out, something similar would happen if just two of the domestic automakers had a serious contraction—precisely the scenario we're talking about here.

We assume essentially the same first year supplier crisis for all automakers in the United States. Production would fall about 50 percent in the first and second years for the international producers.

[snip]

In all contraction scenarios, imported automotive supplies and parts prices are increased by 15 percent because of the probable disruption in the domestic supplier sector.

That is, even with just GM and Chrysler going into bankruptcy or otherwise cutting their production, you'd still have the cascade effect

in which suppliers would go under, making them unable to meet commitments to Ford and the foreign manufacturers either.

To get an idea of what this looks like, consider what happened to GM earlier this year when American Axle went on strike. GM had some time to prepare, and so had several months' stock of the affected vehicles on hand, something which would be true of some, but not all, of the Ford, Toyota, and Honda vehicle lines in question. Yet, as the strike wore on, GM had to idle a number of plants (and sales for those vehicle lines began to fall, though that didn't affect the supply chain). That, in turn, hurt suppliers that are heavily reliant on GM, as GM's orders for their parts declined. So one supplier cuts GM's production, which in turn cuts other suppliers' production. This was a supply disruption caused by one supplier, doing 80% of its work for GM, supplying a relatively simple product, cutting production for just two months, yet it still set off a cascade in GM and GM's key suppliers.

Now multiply that by fifty.

If Chrysler or (especially) GM went under, it would just take a few key suppliers to disrupt the supply chains for the other manufacturers.

And understand, we're not talking just tires and axles and other mechanical items. Some of the parts are highly tailored, involving a year or more of development time, so it's not as if Ford or Toyota can just go to the nearest hardware store and replace one widget with a similar one.

And, of course, it sort of goes without saying, all those suppliers employ a lot of people who would be laid off in such a circumstance. The cascade hits not just auto manufacture, but real people's lives all over the country.