Chapter 3: For General Motors and its Workers, Bad News Comes in Three Ways

General Motors has long been the world’s largest manufacturer of automobiles, and consequently a major employer in the United States. As large as they are, GM certainly does not possess monopoly power, facing heavy competition from Ford and Daimler-Chrysler and a host of foreign carmakers, so the modeling of employer behavior under competitive conditions, as presented in Chapter 3 of *Modern Labor Economics* is applicable to the GM case. Viewed somewhat simplistically, that modeling suggests that firms seeking to maximize profits need to look at three factors in making their labor market decisions: 1) the productivity of their workers (marginal product); 2) the revenue-generating capacity of the firm in selling its output (marginal revenue); and 3) the cost of employing additional workers (marginal expenditure). For General Motors and its workers, there is bad news to report on all three fronts, according to recent articles in *The Wall Street Journal*.

There is a bit of good news to report, so let's begin there first. An article by Joseph B. White reports that GM improved worker productivity more than both Ford and Daimler-Chrysler AG’s Chrysler Group over the past five years. Citing an industry report, he noted that GM also had the most efficient plant in North America, its Oshawa No. 1 in Ontario.

Unfortunately, that's about it for the good news, and even the good news silver cloud seems to have a dark lining. While GM's productivity was up 2.5 percent in 2004, Ford and Chrysler both increased their productivity by 4.2 percent for the same year. And despite their productivity improvements over the past five years, it still takes an average of 6.4 hours longer to make a GM vehicle than it does to make a Toyota produced in North America. That difference gives Toyota a cost advantage of $300 to $500 per vehicle because of lower labor costs, according to the article. But the bad news doesn't stop there. Higher productivity means that more cars can be produced with fewer workers, but it’s questionable whether GM should want to produce more cars: they lost an average of $2,311 on each vehicle sold in North America during the first quarter of 2005. Two factors are at play in this: poor generation of revenues and higher than average labor costs. Toyota's cost advantage might suggest that they would have lower prices than GM, but greater demand for Toyota vehicles—or perhaps more accurately, weaker demand for GM vehicles—allowed Toyota to generate almost $6,000 more per vehicle in revenue than GM. A finding reported that should be of great concern to GM is that their average revenue per vehicle has hardly changed for five years, suggesting a worsening problem. GM also lagged behind Ford by nearly $2,000 per vehicle, and behind Chrysler by nearly $3,500 per vehicle. Not surprisingly, both Ford and Chrysler managed to earn profits on their vehicles, while GM was losing money on each of its sales, on average.

An added reason for the profit disparity is the higher labor costs that GM has compared to its competitors. An article by Lee Hawkins, Jr. and Joseph White reported that GM's production workers enjoy a much better health care benefit than even its own white-collar, salaried workers, not to mention those of its competitors. Having been the largest automaker for so long, GM is also burdened by having a larger pool of retired workers who continue to receive health benefits through GM. While health care costs are rising for everyone, the increased bill for GM in 2005 was reported to be about $1 billion, to a total of $5.6 billion. According to Hawkins and White, citing industry sources, United Auto Workers pay only about 7 percent of their health care costs, while salaried workers pay 27 percent, and the average American worker pays 32 percent. General Motors has indicated that they will seek cost savings from the UAW in their next contract negotiations, but also indicated that they believe that productivity increases have in part been the result of good cooperation between the union and the company. GM lost $1.3 billion in the first quarter of 2005, and along with Ford, had its corporate debt downgraded to junk status.
Sources:

a. If higher productivity rates allow companies to produce the same output with fewer workers, aren't workers simply working themselves out of a job if they find ways to work more productively? Discuss both scale and substitution effects in your answer.
b. When billions of dollars are involved, does it still make sense to talk about marginal conditions on either the revenue or cost side?
c. If GM is losing over $2,000 per vehicle sold, why don't they raise their prices?