

September 2005

Dear Fellow Wage Slaves,

Dry dog food. I hope it's tasty. Like a lot of Americans, my retirement plans revolve around cultivating a taste for the stuff. I spent the '90s enthusiastically buying **dot.com stocks**. Having learned nothing about economic bubbles from that experience, I moved into real estate, like a lemming waddling toward a cliff. Years ago, I politely asked my boss, Bill, whether we had any kind of pension arrangements; his **demonic laughter** followed me as I quickly retreated down the hall to my office.

Me and my countrymen ain't great about saving for the future. Most of the nation's **defined benefit plans** resemble undernourished dinosaurs; their obligations killing legacy manufacturers and airlines alike. Mentioning **Social Security** guarantees groans. US **savings rates** are impossibly low, comparable to Bolivia and Chad. Then there's our small Argentina-like national deficit problem. Meanwhile, globalization means **job security** is a quaint anachronism. Even DMV workers have that nervous look. And there's a guy in Bangalore waiting to write Teal market analysis reports from boilerplate.

With this joyless reality in the background, Boeing's machinist union is making a stand for pensions and job security. BCA management has predictably reacted as though they were offered **jellyphish venom mousse** at a China Southern 777 acceptance banquet. They'll consider almost anything except higher defined-benefit payments. Unlike higher wages, a cost that varies with workforce size, pension payments are **the gift that keeps on giving**. If the jetliner market shrinks, payments stay high, even if company revenue is halved. Throw in pension fund investment uncertainties (changing returns, volatile interest rates) and you've got a recipe for financial disaster. Job security inflicts equal damage, obliterating BCA cost flexibility in hard times. BCA management would be out of their minds to accept this.

But they might have a tough time refusing. BCA machinists are the last union with any power in the US. Boeing is healthy, the market is growing, there's a market share war to be won, and **hiring Oompa-Loompas** as replacements **isn't an option**. For a contrast of union strengths, look at the feeble mechanic's strike at Northwest. Labor may choose to fight a climactic battle with Boeing, a battle to preserve eroding benefits and security that no other union has the power to fight. Other unions may even support the Boeing folks.

The machinists have a few points, other than the sheer power of their position. Boeing management bears some of the blame for past labor relations disasters. From the union view, the **turbofan of capitalism** is oiled by the **blood of machinists**. Boeing laid off thousands of workers, which was bound to have consequences for morale. And, BCA might not have done everything it could to work with labor to keep work in-house. The unions are now less willing to negotiate as partners.

The unions also point to parallel examples, although these don't work. Pensions might be higher at one or two other aerospace companies, but these build products for government customers, who are **much less cost sensitive** than airlines. Lockheed Martin can pass higher pension costs on to the government; higher BCA pensions can't be passed on to anyone, except the struggling

airlines. No US aerospace primes have Boeing's level of commercial market exposure. BCA needs to keep their costs accordingly low.

BCA needs to balance short-term pain with long-term pain. **Waiting the strike out** means a jetliner delivery stoppage, and the high cost of satisfying customers (or watching them defect to Airbus). **Settling the strike now** will damage BCA's long-term cost structure, hurting market share. They'll probably go for the short-term pain. **This means a long strike.** After all, the union strike vote wasn't 66-34. Rather, 86% voted to reject Boeing's offer. This implies militancy. They won't just settle when Boeing sweetens the offer with extended nap times and cookie breaks.

If the strikers get what they want, they should consider retirement as quickly as possible. Higher pension costs will tip the balance in favor of much more outsourcing. Boeing will likely rid itself of as much manufacturing as possible, whether by direct contracting or divestiture. This strike explains why Boeing spun off Wichita to create **Spirit Aerostructures**. Ironically, Spirit would benefit from BCA's increased outsourcing. Is there anyone foolish enough to think Congress will pass laws against outsourcing and offshoring? And if any machinists resent open borders, perhaps they'll make a principled stand against working on jets for foreign customers?

Meanwhile, Europeans are having a good chuckle. It isn't just the opportunity for Airbus to pursue customers annoyed by Boeing delivery delays. It isn't just the predictably smug European attitude that **American hyper-capitalism** is doomed. Rather, Europe has a cost advantage for many industries. If a US firm (manufacturer, airline, etc) competes with a European firm that has pension and health costs taken care of by the government, the European firm has an advantage. Airbus can even use this benefits advantage to pay workers less. Europe has higher taxes as a result of its social largesse, but this burden can be pushed on individuals, not strategically-important companies. This advantage may be on par with Airbus's launch aid. And it's totally ethical.

One answer is the US Pension Benefit Guaranty Corp. (PBGC), which is inheriting the unfunded obligations of many US companies, especially airlines and manufacturers. By one account, total US pension underfunding exceeds \$300 billion. We're looking at either a wholesale realignment of US industry away from pensions (and towards jobs like mine), or a **PBGC-led adaptation of Euro-socialism**. Lucky workers will get residual pensions from the PBGC. For the rest of us, well, I hear one brand makes its own gravy....

As for BCA, they're in a uniquely vulnerable position. They're too healthy for a PBGC bailout, yet too hostage to market reality to increase pension commitments. I have no idea how this strike gets resolved. One solution: give the union a lump sum, and let them handle their own pensions with no future uncertainty for BCA (**five years hence**: "Well, because giving organized labor a large sum of cash *seemed* like a good idea at the time..."). But again, the smart money now is on a long strike.

Until I join them, September's updated reports include the C-17, Tiger, Rafale, F-2, AH-1, Super Puma, Avanti, and the Military Transports overview.

Yours, On Behalf Of Analysts, Timewasters, and Forecasters Union Local 744,
Richard Aboulafia
raboulafia@tealgroup.com
(703) 385-1992 ext. 103 (office)