



## Worker Ire Grows, GDP Share Shrinks as Profits Boom (Update1)

By Elliot Blair Smith

Jan. 19 (Bloomberg) -- Missile assembler Thomas Tanzillo dipped into retirement savings and worked a temporary job to support his family during a 70-day strike at Raytheon Co.'s Tucson, Arizona, plant. He may need years to recover.

His union on Jan. 14 accepted a three-year contract almost identical to the one that sparked the strike: 3 percent annual raises and higher health-care premiums. The deal came after Raytheon posted eight straight quarters of profit growth and awarded missile unit President Louise Francesconi a 19 percent raise to \$1.7 million -- including restricted stock -- in 2005.

The Tucson settlement shows how workers are struggling to keep pace with growing U.S. economic wealth. Company profits as a percentage of gross domestic product are at a 40-year high, rising to 12 percent in the third quarter from 7 percent five years ago. Wages and salaries fell to 45 percent from 49 percent, government data show. Workers like Tanzillo are bitter.

"We don't mind making concessions if the company goes through a few lean years, but now that we're back to the boom years, they're not sharing," Tanzillo, 56, says.

Raytheon spokesman Jon Kasle says the 1,868 hourly workers at the plant consistently received higher wage increases than average hourly workers nationwide.

"We're pleased that the contract was ratified and the strike was resolved," he says. "We're going to welcome the team back to work."

'Battles to Come'

Of the 1,400 active members of International Association of Machinists Local 933, 90 percent initially backed the strike against Raytheon, and an additional 100 non-union hourly workers honored the picket line, says union representative Bobby Martinez. By the time the union ratified the contract, 43 percent of the hourly workers had returned to the job.

"They voted what they thought was the best for them," Martinez, 43, says.

He says the strike was part of a larger cause.

"This is one of the many battles to come in the war on the middle class," Martinez says. "Companies like Raytheon are focusing on making money at any cost, instead of looking at the common good of a community."

Almost three-quarters of Americans believe the growing gap between the rich and the poor is a serious concern, according to a Bloomberg/Los Angeles Times poll in December.

The GDP gap is widening even though wage gains began to pick up late last year. It wasn't until September that average hourly wages surpassed the year-end 2001 rate, adjusted for inflation, according to U.S. Labor Department data.

Average hourly earnings rose 1.7 percent in 2006 on an inflation-adjusted basis, the department says.

'An Indictment'

U.S. workers are only beginning to recover lost ground. After inflation, median family income of \$56,643 hasn't grown since 2001, says economist Jared Bernstein of the Washington-based Economic Policy Institute, which is funded by foundations, companies and labor unions.

``The typical family could end this recovery behind where they started," Bernstein says. ``That's a hell of an indictment given how much income we've created."

The U.S. economy is expanding steadily, with GDP forecast to rise 2.5 percent this year, according to a January Bloomberg News survey of economists. Yet that wealth hasn't translated into greater prosperity for many Americans.

Companies such as Waltham, Massachusetts-based Raytheon, drugmaker Eli Lilly & Co., Goodyear Tire & Rubber Co. and United Parcel Service Inc. have ratcheted up profits while containing wages and benefits like hawks since the recovery began in late 2001.

Unlike earlier expansions, more profit is going to shareholders in the form of stock buybacks than is being earmarked for capital expenditures and wage growth.

#### Shareholders Rewarded

Standard & Poor's 500 Index companies spent a record \$431 billion in stock buybacks in the 12 months through Sept. 30, compared with \$426 billion on capital expenditures, says S&P senior index analyst Howard Silverblatt.

Since the third quarter of 2001, S&P 500 companies have more than tripled their rate of quarterly stock buybacks to \$109.8 billion -- with fourth quarter 2006 buybacks expected to come in at \$112 billion, the second-highest ever.

Over the same period, companies have raised their quarterly dividends 69 percent to \$54.8 billion.

That trend bothers some workers and labor economists, who say the economy's gains aren't being shared equitably. They also express concern that domestic investment in new plants and equipment may be inadequate to protect jobs and incomes.

``We're not economists, but it's not too hard to figure it out," Tanzillo says. ``We're living it."

In the early stages of an economic recovery, profits typically go up and wages down as a percentage of GDP. Wages gain ground later. This expansion is unusual for how long profits have gained share while paychecks have lost.

#### Global Labor Arbitrage

S&P 500 companies have reported four consecutive years of profit gains, with operating earnings rising 13 percent in 2005, 24 percent in 2004, and 19 percent in both 2003 and 2002, Silverblatt says.

S&P estimates that operating profits rose 15 percent last year and will come in about 10 percent higher this year.

U.S. managers, taking advantage of new technologies and emerging economies, can better connect low-cost sources of production with buyers in affluent markets. The wage competition -- which Morgan Stanley chief economist Stephen Roach calls global labor arbitrage -- keeps many U.S. workers' pay in check, stretches their hours and shifts more benefits costs from companies to employees.

``The advent of the Asian workforce has maybe changed labor economics in the long term," United Technologies Corp. Chief Executive Officer George David says.

``The only way to deal with low-wage pressure from emerging markets is to have a higher-educated population doing higher-educated work at higher rates. Don't hang onto the bad work."

#### Two Camps

Economists fall into two camps on whether the U.S. economy can continue to prosper with employers faring so much better than workers. Some, like Bernstein, say that unless wage gains lift worker pay

above the rate of inflation in 2007, consumer spending may become too weak to drive growth.

Others view rising profits and stock valuations as a solid foundation for more growth. James Swanson, chief strategist at MFS Investment Management in Boston, says executives are looking for new investment opportunities to expand and to add jobs.

``We think this link to profits is an augur of stronger economic growth, not a slowdown to recession," Swanson says.

Labor analyst James Sherk, with the Heritage Foundation in Washington, rejects the notion that employers are benefiting at their employees' expense.

``The average unemployment rate of 4.6 percent last year was the lowest we've had since the 1960s with the exception of the tech bubble," Sherk says.

#### Lilly Deal

Nariman Behravesh, chief economist at Lexington, Massachusetts-based Global Insight Inc., takes a broader view.

``What you don't want to do is hamstringing a company from doing what it needs to do to stay competitive," he says. ``Companies are not social welfare organizations."

Still, profits continue to rise faster than the overall GDP growth rate, as companies find new ways to add to their margins.

Eli Lilly plans to buy Bothell, Washington-based Icos Corp. for \$2.3 billion to gain rights to the Cialis impotence drug, which Icos says it expects to top \$1 billion in sales this year.

Simultaneously, Indianapolis-based Lilly plans to fire all 700 Icos employees. That means Lilly can boost sales and profit without adding to its labor costs.

Former Icos scientist Pat Gray says he was stunned by the firings of his ex-colleagues.

``Lilly probably didn't think a whole lot about the people there, and, because this is a business, I guess there's no reason for them to when it comes to the bottom line," he says.

#### `Black Belts'

Lilly has trimmed employment by 9 percent since 2004, even as its per share earnings rose more than 65 percent to an estimated \$2.74 to \$2.84 in 2006, the company says.

Vice President Elizabeth Klimes heads a team of 400 efficiency experts called ``black belts" who search for savings and revenue enhancements. She says the program produced \$250 million in net benefits last year.

Lilly, like many companies whose profits have risen during this economic expansion, spent some of its largesse on stock buybacks, lowering the total number of shares outstanding and lifting earnings per share. It spent \$2.6 billion on share buybacks from 2004 through Sept. 30, the company says.

It also raised its dividend by 6.3 percent to \$1.70 a share in December -- the company's 40th consecutive annual increase.

#### Goodyear Gains

Goodyear, the largest North American tiremaker, has returned to profitability after piling up losses in 2002 and 2003. It is closing plants, cutting payroll and reducing its retiree health benefits obligations in a three-year contract that U.S. factory workers ratified in December.

The Akron, Ohio-based company says the new contract will save \$610 million through 2009. The company will realize \$90 million in payroll savings by the contract's third year by hiring new factory workers at \$13 an hour -- \$3 to \$4 less than for the existing workforce.

``The most significant savings comes from the ability to bring in new hires at a substantially reduced

wage and benefits package," Chief Financial Officer Richard Kramer said in a Jan. 9 conference call with analysts and investors.

Management also won union consent to place \$1.3 billion in retiree health-care obligations into a new benefits trust, funded with \$1 billion in cash and stock. The company estimates it will save at least \$110 million a year starting in 2008.

It still has a \$2 billion unfunded pension liability for U.S. operations.

UPS's Carrots, Sticks

The operating margins in Goodyear's global tire business grew by 5.6 percent through the first nine months of 2006. The company's stock closed 2006 at \$20.99 a share, more than double its low for the year of \$9.75 in July.

"All the other stakeholders are benefiting from the turnaround, and they came asking us for more cuts," says United Steelworkers of America spokesman Wayne Ranick, whose union represents Goodyear factory workers.

UPS, the world's largest package shipper, has wielded both carrot and stick in its labor relations to build on 17 straight quarters of profit growth.

The Atlanta-based company says an automation drive rolled out last year enables management to track each package from pickup to delivery, squeezing out unnecessary steps.

Dock workers now load three to four brown vans per shift, up from two previously, company spokesman Norman Black says. Drivers trimmed 2.95 million miles (4.75 million kilometers) from their routes in November alone -- partly by avoiding left-hand turns -- while handling more packages.

Buyout Offers

At the same time, the company in December offered buyouts to 650 managers older than 50, a month after eliminating 1,200 jobs in its logistics division to reduce labor costs.

"What we're doing is targeting our most senior managers who are closest to retirement, who are also the highest-paid," Black says.

Profit gains enabled UPS to fund a 74 percent increase in dividend payouts and a 6 percent reduction in outstanding shares over the past three years. That includes \$4.4 billion spent in 2005 and 2006 to repurchase about 60 million shares.

The efficiency drive has cost the company in other ways.

UPS will pay more than \$87 million to settle a class-action lawsuit in California accusing it of improperly deducting one-hour meal breaks from the paychecks of 19,762 drivers, who frequently didn't take them, the settlement document says.

The drivers' lawyers and the union wouldn't comment on the settlement, which is pending. UPS denies wrongdoing.

40 Hours 'Obliterated'

Many employers are increasing productivity at workers' expense, says Eric Kingsley, an Encino, California, labor lawyer who wasn't involved in the UPS lawsuit.

"The 40-hour week has been completely obliterated," Kingsley says.

Raytheon workers, who make the Tomahawk cruise missile and other sophisticated weapons, went on strike Nov. 6 for the first time since 1978. Martinez was 15 that year and chaperoned his mother, Esperanza, a union steward, on overnight picket duty.

Martinez says about 470 of Raytheon's hourly missile unit workers haven't received basic wage increases in at least three years, and 120 won't qualify for raises for another three years under the new contract.

Tanzillo, who makes \$43,680 a year before overtime and shift differentials, qualifies for Raytheon's offer of a \$1,000 signing bonus and the 3 percent annual raise. That is less than the 3.3 percent average forecast for union employees nationwide in 2007 by Hewitt Associates LLC, a benefits consultant in Lincolnshire, Illinois.

The plant's workers, representing 2 percent of Raytheon's 80,000 global workforce, make an average of \$39,561 a year.

#### 'Matter of Principle'

Tanzillo says he probably won't recoup the \$9,240 in lost pay nor the \$3,450 he spent on health insurance during the strike. Tanzillo says he got by on a \$4,000 loan from his retirement savings and a temporary job at a catalog call center, at less than half his usual pay.

"I was determined to do whatever I needed to do," Tanzillo says. "Maybe I was foolish, but I took it as a matter of principle and I was surprised by how many other people did."

"In the future, it will be a real battle for everything we get," Tanzillo adds. "That's their job -- to maximize profits and minimize their expenses -- but we'd like to be seen as an asset more than as an expense."

#### CEO Gains

CEOs at the 10 companies comprising the S&P Aerospace and Defense Index, including Raytheon, fare better.

Their cash compensation, consisting of salary and bonus and excluding stock, grew at a 21 percent annual rate, to a median of \$4.17 million in 2005 from \$1.95 million in 2001, says San Mateo, California-based pay consultant Equilar Inc.

That is higher than the 12 percent annual increase received by all S&P 500 CEOs.

A separate analysis by pay consultant Salary.com Inc., based in Waltham, found that Raytheon's five top-paid executives earn 90 percent of the median cash and bonus of executives at the aerospace index companies.

Many Raytheon hourly workers, including procurement specialist Jeff Gary, have seen their pay frozen, or "red circled," after the company ended a program rewarding them for pursuing career-enhancement educational programs.

"My basic rate hasn't changed in six years," says Gary, 45, a union steward. "And they want me to go three more years without a change. It's draining me."

"I'm watching prices go up, and I'm watching my purchasing power go down."

#### 'Wages Are Competitive'

Kasle, the company spokesman, says that although red-circled employees won't receive higher base pay under the new contract, they will receive a lump-sum payment equaling 3 percent of their 2006 earnings, including overtime.

"We're confident that our wages are competitive in the Tucson market and in this industry," he says.

Rising health costs also weigh on workers and retirees. The contract requires hourly workers to pay at least 88 percent more for health insurance over three years, including 19 percent in the first year. Kasle says the increases would bring them in line with salaried workers.

About 100 former employees are suing Raytheon in federal court in Phoenix over the company's 2003 decision to end its policy of paying health coverage for retirees younger than 65.

Retirees say they won the coverage under collective bargaining agreements. Ron Geuder, 61, a retired circuit-board plating specialist, is paying \$1,072.38 a month for premiums he says he expected Raytheon to cover until he was 65.

``I've already lost \$10,000 a year," the 31-year veteran says. ``It's just money that should be in my bank account that's now in Raytheon's bank account."

#### `Lean Manufacturing'

The company argues in court papers that it ``reserved the absolute right" to amend benefits plans.

``Our focus on lean manufacturing -- basically removing waste from our operations -- has demonstrated significant improvements that have allowed us to increase productivity," Kasle says, declining to provide details.

Kasle says Raytheon invested some of its cash to buy back \$788 million of company shares in 2005 and through the third quarter of 2006. He says asset sales will fund an authorization to buy an additional \$750 million in shares. Raytheon in December agreed to sell its business-jet unit to Toronto-based Onex Corp. and Goldman Sachs Group Inc. in New York for \$3.3 billion.

Raytheon has increased its dividend by 20 percent to 24 cents a share over the last two years.

That helped propel the company's stock to a 32 percent gain for 2006, compared with a 14 percent increase in the S&P 500.

#### `Face Reality'

The hourly workers who walked the desert highway picket line in Tucson will return to work Jan. 22 alongside colleagues who crossed the line so the plant could stay open.

``It will be scary for me to go through the gate," says missile assembler and inspector Carmen Fotheringham, 42, a 21-year plant veteran. ``I've been looking at it from the picket line for so long, I have butterflies in my stomach."

Tanzillo says the strike settlement shows that workers have to ``face reality" when it comes to their bargaining power.

``Some people have more bullets in their gun than we do," he says. ``It's hard not to be bitter toward the company. But I do want my job."

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