

The New Treaty of Detroit: Are Voluntary Employee Benefits Associations Organized Labor's Way Forward, or the Remnants of a Once Glorious Past?¹

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¹ This paper is not unlike much of my work; it was inspired by a characteristically clear stated and considered point of view by Lloyd Ulman. 12 months ago Lloyd said to me, "Well its just about time that employers didn't have to pay health insurance." I thought that was a good point and wanted to think it through."

Abstract:

This paper examines the breakdown of a particular form of employee benefit, retiree health, and the transformation of retiree health into Voluntary Employee Benefit Associations (VEBAs). In describing the 2007 auto negotiations this paper explores whether the agreement will be “the New Treaty of Detroit” and pave the way to national health insurance.

Fringe benefits are of importance to such fundamental labor market problems as the social organization of work and production, as well as to social and moral obligations of citizens. They deserve more attention than they have generally received from the economic research community. (Sherwin Rosen 2000: 29)²

The United Autoworkers of America (UAW) struck General Motors on September 24, 2007, for 40 hours, in their first nationwide strike against the company in 37 years. When negotiations broke down, UAW President Ron Gettlefinger quickly assured the media the impasse wasn't about retiree health care – that is not a mandatory subject of bargaining –; which, of course, is what the strike was largely about.³ Three days after the strike ended, and the terms of the contract started to leak out, *The Wall Street Journal* called the settlement on retiree health plans the most important concession the union made.

The UAW agreed to take over almost all responsibility for retiree health care by forming a Voluntary Employee Benefits Association (VEBA). Having agreed to the VEBA,

² Rosen, Sherwin. 2000. “Does the Composition of Pay Matter?” In *Employee Benefits and Labor Markets in Canada and the United States*. Eds. William Albert and Stephen Woodbury. Kalamazoo, Michigan: W.E. Upjohn for Employment Research: 13-30

³ The UAW started negotiating with all three Detroit automakers in the summer and chose GM as their target a week before the contracts expired on September 14. Most observers did not expect the strike because both sides had faced losses in recent years.

the union, reportedly, held out for compensatory job-security language, and for sufficient funding for the VEBA. Based on past practices, Ford and Chryslers' contract with the UAW should be similar.

The first part of the paper discusses the emergence of the VEBA as a predominant issue in the changing employee-benefit environment. The second section describes VEBAs. The third explains the origins of retiree health care. The fourth section describes the 2007 UAW – Detroit Three negotiations and speculates about what the VEBA might mean for the UAW; and, the last section discusses what the VEBA might portend for health care and organized labor.

1. The Old Treaty of Detroit and Employee Benefits

In the post-World War II period, American labor and management agreed upon a set of rules about pay, benefits, and work rules that supported middle class lives and industrial piece and social order. A shorthand reference to that framework was what a *Fortune* Magazine article had called the Treaty of Detroit, the 1950 collective bargaining agreement between GM and the UAW that was preceded by a 104 day strike. Frank Levy and Peter Temin's widely publicized 2007 working paper⁴ attributes the growing gap in income among American households to the break down in that "Treaty of Detroit," which, they describe, provided that workers' pay increases would equal the growth in labor productivity.

⁴ Levy, Frank, and Peter Temin, "Inequality and Institutions in 20th Century America," NBER Working Paper 13106, May 2007.

As historian Nelson Lichtenstein observes, *Fortune* magazine editors were probably more enamored with the unusual length of the contract – five years -- in which the workers promised not to strike and ceding to management the decisions about what cars to build and how to build them, in exchange for wages tied to productivity, and for extensive health, unemployment, and pension benefits, expanded vacation time; and cost-of-living adjustments to wages.⁵

Levy and Temin uses this agreement as a reference to what was once American economy-wide norms that governed the distribution of revenue between firms and workers. The idea that workers' pay was once aligned with workers' productivity, because workers had economic influence to counterweight corporate power, is the foundation for their benchmark, their measure of changing norms about fair pay. They compute a measure of worker bargaining power. It is the ratio of median annual compensation of full time workers (pay and fringe benefits) divided by the annualized value of output per hour – as the best measure of labor productivity – to show that the decline in this ratio correlated well with a decrease in median workers earnings and a rise in income inequality.⁶

The measure is as good as any shorthand measure of worker bargaining power; but it does miss a crucial element of that “Treaty.” In 1950, the UAW demands in collective

⁵ Lichtenstein, 1995. *Walter Reuther: The Most Dangerous Man in Detroit*. University of Illinois Press

⁶ In the quarter century between 1980 and 2005, business productivity increased by 71%. Over the same quarter century, median weekly earnings of full-time workers rose from \$613 to \$705, a gain of only 14% (figures in 2005 dollars), as our recent research shows

bargaining were not unlike those of other unions in other industries.⁷ In that period, as the unions battled to set norms, they sought to shape the contours of compensation in order to alter the distribution of not only pay, but of the risk of losing work and the ability to work, because of market dynamics or human fragility.

Temin and Levy's measure does not capture the shift in risk-bearing between workers and owners for risks such as: illness and injury, unemployment, consumer sentiment, superannuation (being too old to work, or too old for anyone wanting to put you to work), living "too long" after retirement, etc.. For example, in any given year, a firm may contribute the same amount in its workers' 401(k) plans, as it does for the defined benefit pension plan. But, the eventual benefit adjusted for risks and fees -- high administrative fees and financial, investment, longevity, inflation and other kinds of risks -- of each kind of plan are clearly different.

In addition, Levy and Temin would likely conclude the Old Treaty is still in place in the auto industry, because the workers are represented by a union and pay is linked to productivity. Because of the increase in the cost of retiree health insurance and the aging of the work force, especially those who have retiree health insurance, the disjuncture between pay and productivity is not severe, perverse, or present, as Levy and Temin make out for the entire economy. Clearly, the productivity of US auto workers is falling for the Detroit 3 as

⁷ There is not a rich literature charting the timing of the inclusion of employee benefits in collective bargaining agreements (Sass 1996, Klein 200tk, Ghilarducci (1992), Stevens (1986) Slicther, Healy and Livernash 1950). One guide is that young Lane Kirkland was tasked by the newly formed AFL-CIO to rationalize labor's position on "the composition of pay" that culminated in a 10 point bargaining agenda for all unions to follow – health benefits were hardly mentioned (pensions, unemployment insurance, cost of living increases, joint control of prefunded pension fund investments were more prominent).

many of the workers they are still paying retiree health benefits to don't work or produce anything for the company. In fact, in the existing GM VEBA (later) most of our beneficiaries never worked for GM; they are the surviving spouses.

The treaties haven't changed terms in 2007; the circumstances in Detroit and the nation have. Unions – including the UAW -- have lost bargaining power as unionized employers produce less market share. (Flanagan's paper on orchestra unions is considered here.) The industries aren't dying -- demand for coal, steel and even American-made cars are growing. The Detroit 3 produced over 73% of light vehicles sold in the U.S. in 1980, foreign plated domestics made up 2%, and the rest were imports. In 1996, the Detroit 3 produced about the same share of vehicles sold in America as they did in 1980. But in the ten years between 1996 – 2006 their market share fell to 53%.⁸

So, a new version of the “Treaty of Detroit” is being rewritten. I maintain the treaty is not a complete capitulation by unions, including the UAW, though it is tempting to describe the role of shrinking unions in sick industries as hospice nurses where unions negotiate palliative care – job banks, severance pay, buyouts, and retiree health care -- to make the doomed more comfortable.

A more hopeful “non-hospice,” scenario, is that VEBAs could, if they take the right form, become the employee benefit of the future and help unions attract workers AND employers. Perhaps the new Treaty of Detroit will show the nation the way forward towards social insurance (employee benefits) de-linked from employers. Unions facilitate forms of

⁸ Strauss, William.A and Emily Engel. 2007. “Transitions: The State of the Automobile Industry—A Summary.” *Chicago Fed Letter* The Federal Reserve Bank of Chicago. Essays on Issues. Number 242a. September p.1.

pay that provide long term security and pair this advocacy with complementary federal programs. The DB pensions were negotiated as the labor movement gave unwavering support for strong Social Security, disability, unemployment insurance and worker compensation programs.⁹

A major drawback to VEBAs is that they don't do anything to contain health care costs and, therefore, probably are not sustainable. Many, including myself, view VEBAs as transition vehicles, a stop-gap measure, between now and when there is national health insurance. Employers and unions were saying the same thing when they were setting up VEBAs in the early 1990s, when national health seemed doable. Indeed, health care VEBAs could work like employer pension plans do -- they complement Social Security benefits -- they are not substitutes for a government pension program.

Everyone expected the summer of 2007's bargaining round to deliver concessions and, although the UAW has made concessions for twenty years, this one has a new flavor— all three companies are threatening insolvency – and all three want to shift health care costs to the union. For employers that have retiree health promises, GM's VEBA may be good news. And, ironically, unionized employers may, perhaps for the first time, be glad the union is there as an institution that lets them offload the company's responsibility for retiree health care, but allows the company to still offer retiree health benefits to their employees. GM's VEBA may be the new vehicle (pun intended) that allows all employers to more easily

⁹ Budd, John W. 2005. "The Effect of Unions on Employee Benefits: Recent Results from the Employer Costs for Employee Compensation Data." Compensation and Working Conditions Online, June 29. Accessed September 27, 2005, <http://www.bls.gov/pub/cwc/cm20050616ar01p1.htm> September 27, 2005.

unwind their responsibility in providing an important source of social insurance at the workplace.

Wall Street is guessing how much the new treaty of Detroit treaty is worth. On September 12, Citibank predicted GMs “long-term turnaround is heavily tied to the outcome of this fall’s labor negotiation.”¹⁰ The analyst predicted that if GM did not get a concession the stock will fall to \$26 a share, from the low \$30s.If GM got the UAW to agree to form a Voluntary Employee Benefits Association (VEBA) the stock would soar to \$57 per share if GM paid less than 70% of the liability. In the few months leading up to the negotiations, GM valued the liabilities at \$55 million. The settlement, as being reported as of Sept. 30, 2007, requires GM to pay under 53% of the liability -- \$29.5 million (reportedly the UAW can go back to GM for a few million more under certain circumstances). No wonder the UAW negotiated that some of the contributions to be GM stock options – Wall Street should be pleased with the settlement.

Why is a VEBA worth so much to Wall Street? What will it mean for the UAW – will this contract be the basis for organizing nonunion workers in the auto-industry? UAW dissidents claimed the VEBA plan would inhibit political activity for national health insurance. Yet, the VEBA framework could mean a new role for unions for American workers. Next I’ll describe a VEBA.

2. VEBAs.

¹⁰ Parks. Bob. 2007. “Favorable Risk-Reward Around Labor Talks Drives a Trading Buy.” Citigroup Research, A division of Citigroup Global Markets Inc.Citigroup Global Markets, 12 September

Though VEBAs have existed since 1928, in the public and private sectors, they are not well known. A VEBA is a tax exempt trust organization defined under 501(c) Section (9) of the tax code¹¹ – this section defines tax-exempt organizations like the Elks clubs– that funds qualified employee benefits: qualified benefits meet IRS standards. The employee benefits can not be redeemed for cash and are thus exempted from income tax, including medical (including drugs, vision, and dental) accident, life insurance and other benefits. VEBAs have several tax advantages. Employees (and/or employers) don't pay tax on any of their contributions and earning as long as everyone has to pay. The distributions, unlike in pensions where workers eventually pay tax, are never taxed.

VEBAs can be set up as individual accounts or defined contribution plans (DC), defined benefit (DB) plans, or a hybrid between DB and DCs. Individual plans operate like a 401(k) or any other deferred contribution account and the funding come from the individuals and is not taxed. But since the worker can not redeem the benefit for cash and, crucially the contributions are must be voluntary (hence its name) AND somewhat mandatory for all eligible individuals. If contributions were purely voluntary, then the account would look like regular taxable account and not be eligible for tax favoritism. This provision makes VEBAs ideal employer plans for union involvement. In order for the VEBA to qualify as tax-exempt qualify the contributions have to be voluntary but not discretionary. The contributions have

¹¹ The section of the IRS tax code that defines VEBAs as not-for-profit organizations reads as follows: “(9) Voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries, if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.” Source: accessed on line on September 29, 2007
http://www.gpo.gov/uscode/title26/subtitlea_chapter1_subchapterf_parti_.html

to be made on a consistent basis and dedicated to a tax-qualified purpose. The employees in the VEBAs must control the account or control who manages the account or trust. Because unions, in democratic societies, are voluntary organizations, a collective bargaining contract is one of the few vehicles that combine a savings discipline and voluntary contributions.

Second, a VEBA can be a commingled trust that is a DB plan, and the employer and employees, or just the employees, funds enough to pay for promised benefits. VEBAs are more likely to be hybrids between a DC and DB, somewhat like Taft-Hartley pension and health care plans are set up now. In hybrids, employers enjoy stable contributions; but the individuals are promised a defined benefit that is actuarially funded by the amount of resources in the fund. However, if the fund is insufficient the VEBAs trustees must reduce benefits.

As mentioned above, unionized employers have advantages over non union employers in setting up a VEBA. VEBA membership must consist of employees (or their beneficiaries). They do not have to be employees of just one company but must be employees that constitute an employment- related common bond – like part of an employment agreement or be retirees.). VEBAs formed by collective bargaining can easily meet these provisions.

Most of the collectively bargained VEBAs are trust funds where the employee and employer contribute to a fund and people can immediately collect a benefit. The investment risk is borne by the trust and the administrative fees are lower than individual accounts

because of scale economies.¹² Private employers may only deduct one year's worth of claims and expenses for nonunion employees in any year. This makes non union employers not want to prefund promised non pension benefits.

There are at least 2,700 VEBA's already in existence for union and non-union employees in industries ranging from steel to utilities to telecommunications. The UAW has bargained for several before the GM and Ford VEBA's in 2006. Many mostly fund unemployment benefits for Big-3 companies or major auto part suppliers (Visteon, Delphi, Johnson Controls, and Dana). In December 2006, Goodyear and the United Steelworkers established a \$1 billion VEBA for retiree health care that will be managed entirely by the union (more below). The UAW agreed to a more extensive VEBA for the Dana Corporation in 2007 as an outcome of the bankruptcy negotiations.

The 2007 GM VEBA is certainly not the last VEBA and it certainly isn't the first. Even General Motors already has a retiree-health care VEBA. In Spring 2006, the UAW and GM (as did Ford in the Fall of 2007), transferred a portion of the companies' exposure to retirees' health care expenses to a trust fund called a Voluntary Employee Beneficiary Association (VEBA).¹³ At \$3 billion, the GM VEBA is now the largest VEBA in existence (See Box 1). But the GM-UAW (and any subsequent Ford and Chrysler VEBA's) will be over ten times that size.

¹² Much of this information is taken from Richardson, Michael and Daniel R. Salemi. 2007. "Finding Postretirement Health Benefits Through a VEBA." *Benefits and Compensation Digest*. September. www.ifebp.org

¹³ I am a trustee of the Independent Defined Contribution Health care Trust for UAW retirees of General Motors.

Box 1: The Independent Defined Contribution Health Plan for UAW Retirees of General Motors (agreed to in 2005 and accepted by the courts in March 2006.)

Under the GM VEBA agreements the company still pays most of the health insurance premiums, and therefore is exposed to the risk of medical inflation (and longer lived retirees). Here are the conditions for the GM-UAW 2006 VEBA:

- Retirees (except for the very low income retirees*) pay out-of-pocket expenses for health care for the first time: \$752 per year in premiums, co-payments and deductibles. The VEBA mitigates some of the retiree's portion of retiree health insurance premiums and pays for dental insurance premiums.
- GM: \$3 billion into a trust fund by 2011 (which will mitigate costs to retirees) and 5.3 million shares of stock options.
- Workers (active UAW-GM workers forego \$1 an hour in future pay increases, and the 3% wage increase scheduled for September 2006.
- After December 2006, an additional 2 cents of each quarterly COLA (Cost of Living Adjustment) will be deferred. (60,000 workers took buyout and don't contribute and gave up rights to retiree health care which reduces the income into the VEBA.)

* UAW-GM retirees with GM pension incomes of \$8,000 and less and whose GM pension benefit rate is \$33.33 per month per year of service or less will not be affected by the proposed changes in the tentative agreement.

3. Retiree Health Care Liabilities: Legacy Costs and Legacy Benefits

Two-thirds of large (more than 5000 employees) companies in 2007, and one third of all companies, provide retiree health care plans to people who retire before age 65 or supplements to those who collect Medicare.¹⁴ In the 1980s, most large companies and two-thirds of smaller companies had some retiree health plan. The Detroit 3 automakers always included retirees in their negotiated health plans. The foreign-owned non union transplants were never among the companies that promised such benefits (Toyota gives up to \$3,000 per year to retirees to help pay for their premiums. In contrast, the GM cost for each retiree is about \$1,500 per month.) Almost all public employees, and most teachers, have some sort of

¹⁴ In 2005, 33 percent of small firms (200 or more workers) offered retirees health coverage in 2005, down from 66 percent in 1988, (Kaiser Family Foundation.)

retiree health benefit. Retiree health benefits can be merely a defined amount of cash the retiree can use to help pay an individual's insurance premium or it can be coverage under the health plan for active employees.

In a 2006 survey of 163 large companies (Watson Wyatt Worldwide), 95% of companies who have retiree health care will restrict access for future workers; 50% will have retirees pay higher premiums and put a cap on the employer's contributions. The retiree portion of employee health insurance can be huge – it can take up half or more of a person's pension benefit. The cutback in retiree health benefits started in the early 1990s, as accountants began to look more closely at their size.

In 1993, the Financial Accounting Standards Board (FASB) required large companies to “book” their retiree health benefit liabilities and deduct them from reported profits. IBM took a \$2.3 billion charge and G.E. took a \$1.8 billion charge. Many Baby Bell companies and utilities establish VEBAs. Ball Co. eliminated its retiree health benefits in the 1990s when the FASB rule was implemented, admitting the costs were unpredictable and too much of a business risk. Very few companies (91 employers out of 1385 in one survey [Mercer¹⁵ 1993]) prefunded the retiree health benefits (provided a stream of income to pay for insurance premiums exclusively). All in all, very few companies put real money away in a dedicated fund to pay for future retiree health benefits (some put more money into underfunded pension funds to get the tax-benefit, but that money is for pensions, not retiree health insurance).

¹⁵ : Freudenheim, Milt. 1992. Paying the Tab For Retirees.” *The New York Times* January 21.

The logic for accounting for health care liabilities caught up with the public sector in 2007. Taking up the point of view of the state and municipal bond purchaser, the public sector's analog to FASB, the Government Accounting Standards Board (GASB), will require Governmental units to account for retiree health liabilities. Some units are creating ways to prefund retire health liabilities in VEBA and other kinds trusts. Some others are booking the liabilities, and continuing to pay for the retirees' health care premiums as they have handle health costs for active employees, on a year to year basis. Texas acted similarly to the Ball Corporation. It said that it would not comply with GASB rules because it had no liabilities, in fact, because their retiree health benefits can be revoked at any time. Bottom line any employee promised retiree health liabilities faces a decline in benefits and/or a VEBA in her or his future.

The FASB reporting requirement reduced share prices and earnings for the firms that offered retiree health benefits between 5 and 230%. The auto industries earnings fell by an average of 35% when the companies first put the extent of the liabilities on its balance sheets. That means that investors paid for the liabilities when they were booked and those who bought stock at its discounted price gained as the stock rose over time.

The view that the retiree health liabilities are not affordable is very different than the notion that they are very high. The auto companies may have decided that getting concessions from the union on retiree health care was the most significant achievable concession. Yet, the inflation rate for retiree health care costs was probably higher in 2007 than any one expected for 3 reasons. Companies have been shedding workers who are younger than age 65 at a higher than expected rate, which increases the number of retirees who are not yet eligible for Medicare, which jacks up the health care premium. The

accelerated layoffs also reduce the number of production workers who form the base to pay for retiree health benefits. So though Detroit 3 worker productivity has increased considerably, the increase may not be enough to make up for the increased post employment costs. Three, Medicare reimbursement rates is rising at a slower rate than health care costs (however, the subsidies employers receive from the Medicare Reorganization Act of 2005 mitigate the rising expense of covering retirees over age 65).

In 2004, retiree health care represented 70% of GM's total health care bill, pay as you go health care bill. According to press reports in 2007 the auto firms have over \$115 B in present value liabilities, which at today's interest rates would require about \$81 in funding and according to the press reports the auto firms only have \$60 billion in cash. The actual size of retiree health liabilities depend heavily on the assumptions about health care inflation, the number of retirees¹⁶, and perhaps the strategic goals GM has for the numbers. Let me consider the later point. In 1993, GM reported its retiree health costs were \$28B. In 2003 and 2004 the company reported that the liabilities were worth \$63 billion¹⁷, by the time 2007 negotiations came around the company settled on a \$55 billion number. A lower estimate

¹⁶ The liability for retiree health benefits is measured using actuarial assumptions which include the discount rate, and the amount and timing of future benefit payments, which depend age, health care cost inflation and Medicare reimbursement rate. In addition to assumptions specific to retiree health plans, actuarial assumptions must be made about employee turnover, retirement age, mortality, and the number of covered dependents. Cristea, Carrie 1993. "Recognizing retiree health benefits: the effect of SFAS 106." *Financial Management*, June 22.

¹⁷ In 2003, the Wall Street Journal reported that the GM retiree-health liability was \$63.4 billion (GM Says Retiree-Health Liability Rose Despite Medicare Benefit" Wall Street Journal Abstracts, March 12, 2004, Page 12). In 1992 the reported liabilities were \$28 billion (Givant Star, Marlene. 1992. "No rush to buy GM stock; Despite overhaul, investors see trouble for automaker." *Pensions & Investments* November 9.

would make the lump sum they offered to the UAW to take over the liabilities more significant.

GM and Ford are like mini-welfare states and their aging populations look like nation with no one being born and everyone getting older.¹⁸ The Detroit – 3 have a total of 180,681 workers and over 419,000 retirees. They are practically closed groups -- low fertility Swedens. Unless a closed group’s future liabilities are fully funded the pay as you go costs are going to be very high. In contrast, Toyota for example has very few retirees and a very limited retiree health plan; in 2004 it offered less than \$3000 a year for its tiny numbers of American retirees to buy health insurance. These retirees are not even in a group pool that obtains reduced group insurance rates (to include retirees in an employee pool would be subsidizing them, retirees’ health premiums are often 3 times that for young active employees.)

Table 1
Costs of retiree health care (Present value for 20 years)

	September 2007	Ratio retirees/workers
GM	\$68 b (50 b UAW)	2.5 to one
FORD	\$31b	2 to 1
Chrysler	\$16 b – 19b	1 to 1
Toyota and Honda	Negligible	Under 1,500 retirees
Total	\$115-118 b	

How did the costs become so large? One answer is “American exceptionalism.” This is a term used to represent a set of reasons why, in the post World War II period, Americans

¹⁸ Howes, Candace. 1991. “The Benefits of Youth: The Role of Japanese Fringe Benefit Policies in the Restructuring of the U.S. Motor Vehicle Industry” *International-Contributions-to-Labour-Studies*. 1991; 1(0): 113-32. I contributed extensively to this article.

get most of their social insurance through their employers --- and why this country doesn't provide universal health insurance. The collective bargaining process in the U.S. contributed to the privatization of social insurance at the employer level, but being a business union it forwent progressive solutions to maintain its own survival. (Note that Jill Quadagno¹⁹ makes a persuasive argument that the political power of insurance companies mostly explains why the US doesn't have universal medical insurance.)

That narrative about retiree health care, using the framework of "business unionism," is that unions fought hard to include post employment retiree benefits in collective bargaining agreements (it was a hard fight, because they weren't even mandatory subjects of bargaining) and companies went along with it because the alternatives, a strike, or national health insurance, was worse.

I disagree with that analysis. When the UAW and the Big Three included retiree health benefits it was a trivial -- "top-up" kind of benefit, cheap to administer but it was nonetheless vital to the UAW which had a high degree of intergenerational solidarity. Retiree health benefits also greatly helped the auto companies manage. The retiree health benefits were a stop-gap between the age people would retire and the age at which they would receive Medicare which made it much easier for GM (and such) to layoff older workers. Retiree health benefits are a way to give a pension hike. The cost of retiree health in 1993 was less than \$400 per retiree per year; by 2007, it was \$15,000 per year. The taxpayer subsidy for these benefits is large, and the pension and the retiree health care provisions are just private

¹⁹ Quadagno, Jill. 2005. *One Nation Uninsured: Why the U.S. Has No National Health Insurance*; Oxford University Press.

supplements to a strong -- and with hope, stronger welfare state which includes Social Security and Medicare. In this Soskice (see conference papers) is right, American Exceptionalism is overblown.

4. 2007 Auto Negotiations: The New Treaty of Detroit

Usually auto labor contracts are 4 years long; but this last one was really just two years old, because, in 2005, the UAW reopened their contract – this was only the second time the union had ever reopened a contract in the UAW’s 72-year history. GM had convinced the union leadership that retiree health care costs was forcing the company into bankruptcy, at worst, and making GM unable to invest, at best. Using similar arguments, Ford got the same arrangement from the UAW a few months later.²⁰

The UAW and the Detroit Three auto firms have negotiated terms of downsizing over the last 3 years; the UAW has been negotiating concessions for the last 20 years. In the last two years the UAW has agreed to the elimination of 70,000 UAW jobs, an elimination of unemployment insurance called “Jobs Banks” and has agreed to some outsourcing. The UAW has 510,000 active members and about as many retirees. In 2007, more cars will be built by non-union workers. Wages and benefits cost unionized automakers \$70- \$75 per hour; the nonunion plants pay the same wages (\$27.00 per hour), but have a young workforce and do not offer retiree health benefits.

²⁰ Goodyear shares rose to a year long high the day the Goodyear VEBA was announced (it rose to \$21.27 from a 12 month low of \$9.75.)

By mid-summer, months before the UAW contract with the auto companies would expire on September 14, the business press echoed GM's insistence that a VEBA for retiree health care was an attainable goal. In fact, J.P. Morgan Chase issued a research note July 10 upgrading Ford and GM, because the analysts assumed the UAW would accept a VEBA.

The UAW's concession should come at no surprise. The UAW negotiated a VEBA at Navistar in 1992 in the depths of a recession, and, in 2005 and early 2006, agreed to create a partial retiree-health VEBA at General Motors and the Ford Motor Companies. The UAW's acceptance of VEBAs has accelerated. In July 2007, the UAW and the United Steelworkers of America signed a four-year agreement with the Dana Corporation to help the auto parts supplier reorganize out of bankruptcy by unloading its obligation to pay retiree health care and long-term disability coverage by forming a VEBA with a one time Dana contribution of \$700 million cash. Once Dana emerged from bankruptcy, it would provide \$80 million in stock. The union -- not an independent trust -- will be the administrator. The amount represents 71% of total liabilities (which could, with investments, fully fund the anticipated costs). The media took note of the agreement with Dana's new private equity owner,

The Haw's cooperation is something of a reversal for Mr. Gettelfinger, who vehemently criticized private equity funds during DaimlerChrysler's effort this year to sell Chrysler. He subsequently surprised his members by endorsing the deal as being in their best interests.²¹

²¹ Maynard, Micheline. 2007. "U.A.W. Pact With Dana Suggests Softer Stance." *The New York Times*, July 7. p.C1

The UAW is not alone. In the 1990s the United Steelworkers of America negotiated a partially funded Voluntary Employee Benefit Association for retiree health care at Republic Technologies International LLC, in an attempt to preserve wages and benefits for 2,500 workers at the bankrupt firm. Republic had been operating under Chapter 11 bankruptcy protection for a year.²² The USWA agreed to a union run VEBA for Goodyear Tire and Rubber Company retirees after an 86 day strike in 2006. The VEBA accepted \$1 billion in stock and cash from Goodyear to pay for retiree health care liabilities [this is about 60%] of total liability. When the money runs out it is the union that has to tell the retirees that their benefits will have to be cut).

The third piece of evidence for the prediction that the union would accept a VEBA is that they are a popular tool for distressed companies. Without them a bankruptcy is particularly hard on retirees. In 2000 8,000 hourly LTV retirees and their dependents were spared desperately searching for affordable insurance for a few weeks because of a VEBA. Management employees of the steelmaker LTV lost all their retiree health benefits, while the retired hourly workers got theirs paid a little longer, because the Steelworkers negotiated a Voluntary Employee Benefit Association, or VEBA. That VEBA only lasted for a month, but the principle is the same. Even though the company reneged on lifetime health benefits, the benefits lasted a little longer than the company.

Vandalize Employee Benefits Again (VEBA)?

²² Gerdel, Thomas. W. 2002. "Steelworkers announce wage deal with Republic." *Plain Dealer*. April 27. Pg. C1.

But, agreeing to a VEBA will not be easy for the UAW. The UAW's well-organized dissident group, activated when the union first negotiated concessions in the 1980s, took note that VEBAs accompany nearly dead companies and that GM was profitable. Also, because companies are perceived stronger in financial markets when they offload retire health liabilities. The dissidents argue that a VEBA protects the companies from health care inflation and the retirees, the beneficial owners of the trust take that risk on, only to boost profits.

They also argue that risk is too high. Unfortunately, for the UAW negotiators, that the Caterpillar VEBA established in 1998, with \$32.3 million to pay for premiums for Caterpillar retirees, was out of money by the end of 2005. (There are lawsuits pending to determine who is responsible for giving retirees the low-cost health care plans they were promised – but the intention was for the retirees to take the risk.) The dissidents also point to the events leading up to the 2005 and 2006 agreements to form VEBAs at GM and Ford.

In October 2005, the UAW explained that the union negotiating parties (including a retiree organization), did not want to be responsible for making the UAW or GM a Cheshire cat – having a great retiree health benefit -- the grin²³ – with no body to support it. GM opened its books and convinced the UAW it needed help to avoid bankruptcy and to reinvest in North American operations. Here is what the UAW told their membership when they agreed to the VEBA.

²³ I don't know where this perfect metaphor for American unions originated but I credit the first person I heard it from Lloyd Ulman. He was describing the ILWU long shoring agreement specifying A and B members in the early 1980s in class

*The leaders of the UAW unanimously endorsed this tentative agreement...on health care with GM (it) is the result of an in-depth analysis of GM's financial situation and weeks of intense discussions with GM.... Our goal was to provide the best possible health care benefits and ensure that GM is a competitive and financially sound corporation that can continue to provide good wages and benefits for decades to come.*²⁴

And the UAW recognized that the VEBA would not solve the challenges facing the retirees and the company by coming out for single payer health insurance.²⁵ Notably GM did not support single payer until it joined the other two Detroit automakers in calling for it in a meeting with President Bush, immediately after his Republican party's 2006 Congressional defeat.

By May 2006, the 2005 GM-UAW retiree health-care agreement seemed to have paid off for GM, as the UAW expected. After the VEBA was announced, GM reported a *\$445 million quarterly profit, instead of a \$323 million loss "mainly because of accounting changes related to a plan to cut health-care benefits for union retirees."*²⁶ In late 2005, the GM stock price was below \$20 per share when the contract was reopened and peaked at \$38 at the end of May 2007. (By comparison, Ford's stock price was above \$14 per share at the end of 2005 and in May it was \$9.50. Toyota's was \$80 per share at the end of 2005 and now over \$130 per share.)

²⁴ UAW. 2005. "UAW statement on tentative agreement with GM". UAW headquarters, Detroit, Michigan. October 20

²⁵ "The UAW has long advocated single-payer national health insurance as the most cost-effective and fairest way to fix America's health care crisis. Today, we are more determined than ever to make single-payer national health insurance a reality."

²⁶ Freeman, Sholnn 2006. "GM Revises Results, Has 1st-Quarter Profit;Accounting Change Related to Benefits." *Washington Post*. May 9.

The continuing enthusiasm for VEBAs by the business community -- an article for the human resource professionals is titled “Viva la VEBA!²⁷” – continues to fuel UAW dissidents. At a May 2007 meeting the dissidents issued a pamphlet titled: “VEBAs - Vandalize Employee Benefits Again?”

VEBA is a plan for the company to walk away from retiree health care commitments, and shift all the risk to you.; VEBA lets the companies off the hook, and puts the UAW in the divisive position of taking responsibility for and limiting benefits.; An underfunded health care plan is a prescription for disaster. Some VEBA plans are already broke. (Caterpillar, Detroit Diesel. Bottom line: “We don’t want a VEBA. We demand fully paid company health care until we win comprehensive national health care for everyone. [see U.S. Rep. John Conyer’s Bill HR-676]” No to VEBA. Yes to National Health Care.)Source: <http://www.soldiersofsolidarity.com/>)

5. What do VEBAs mean for the Future of the Labor Movement and National Health Insurance?

America has a national health insurance system paid for by the American taxpayer. The current system is composed of for-profit health insurance plans which aim to pool the risks of health care claims in order to increase the chances that someone else pays the claims. That business plan calls for many expensive actuarial and administrative staff hours – adding up to an estimated 10 – 30% of health care costs. The system is heavily subsidized by American taxpayers, because over \$100 billion per year in taxes are not collected on health insurance premiums. These large tax advantage means the system is already a part of public policy, as Yale Historian Jennifer Klein recently argued. But, the obvious rational solution,

²⁷ Steve Davolt. 1996. “Viva la VEBA! Benefit trust ready for a comeback” *Employee Benefits*

creating one risk pool, doesn't depend on delinking employers from paying for it. Employers never paid all of the costs, yet employees and the government are picking up more of the costs of health insurance.

Also "linking" the health insurance to employers has helped employers in the past. Though retiree health benefits now constitute legacy costs, like all legacy costs, there were legacy benefits attached. The Detroit automakers were profitable and strike free for decades. Also, GM and Ford investors already paid the legacy costs (see mention above of the stock decline in the 1990s when the FASB health care liabilities were reported.) The labor peace won in the 1950s and 1960s was, in large part, due to employers promising pensions and retiree health. Retiree health costs were a small part of the expense. When ERISA passed in 1974, it codified what companies like GM were doing anyway; the law insisted that firms advance pay for the pension costs (most of those contributions got passed to workers in the form of lower pay), while the employer garnered enormous tax advantages. The law leveled the playing field for union employers.

The bottom line is that people's retiree health needs won't go away. Americans will always need supplements to Medicare. This bottom line begs the question: Are agreements in Detroit right now (as implausible as it may seem!) providing progressive models for the future.

On the one hand, they are not. The track record of the many VEBAs -- Voluntary Employee Benefit Administration -- in the auto, steel, rubber, and the auto parts industry -- is

that they serve as a form of “hospice” care for workers in dying companies. See the endnote for the list of recent VEBAs²⁸

Some VEBAS were established by companies that needed relief and concession for unions. Some companies set up VEBAs to contain the health care costs; but, were not in financial distress or trouble. Very few of them were unionized, suggesting that companies that are unionized can get these deals when it is threatening to lay off workers.

I leave this section with questions for further research. Will the VEBA and job security provisions attract Toyota and Toyota’s workers? Will national health insurance help the UAW and can the UAW use the VEBA to lobby for national health insurance?

6. Conclusion.

This paper examines the breakdown of a particular form of employee benefit, retiree health, and the transformation of retiree health (and perhaps other benefits) into Voluntary Employee Benefit Administrations. It complements three other chapters in this collection –

²⁸ The list below represents the current (large sized) Retiree VEBAs. There are other “VEBAs” that are run by companies without any retiree involvement. Those are generally created for tax and/or collectively bargained reasons.

1. Dana VEBA; 2. Goodyear VEBA; 3. GM/UAW Retiree VEBA; 4. Ford/UAW Retiree VEBA; 5. International Truck and Engine Supplemental Plan; Singer Retiree VEBA; 6. Federated-Allied Retiree VEBA, 7. National Steel Retiree VEBA, 8. Kaiser Aluminum Retiree VEBA, 9. Allis Chalmer Retiree VEBA, 10. White Motors Retiree VEBA, 11. International Steel Group Retiree VEBA (Bethlehem, LTV), 12. Special Metals Retiree VEBA, 13. Midland Colt Retiree VEBA, 14. CF&I Retiree VEBA, 15. Geneva Steel Retiree VEBA, 16. Pan Am Retiree VEBA (pretty much closed down), 17. Eastern Airlines Retiree VEBA (closed 10 years ago), 18. Copperweld Steel Retiree VEBA, 19. J&L Specialty Retiree VEBA, 20. Republic Steel Retiree VEBA, Other similar plans but not setup as a VEBA. In these situations, there are funds promised for benefits but not necessarily funded. The retirees have varying levels of control of the benefits.

Soskice on American Exceptionalism, Flanagan on union bargaining power, and Levy and Temin on compensation and productivity. The UAW's new stance with Detroit auto companies is a tool in its own strategy to establish labor standards in the industry. Half of autoworkers in the United States are not represented. These American autoworkers are younger, but they are also human and will eventually need retiree health benefits (see BOX). That is a fact that no industry or nation can avoid, whether it has a unionized work force or not. It is possible that VEBAs, and other jointly agreed upon industry wide arrangements, can help shuffle the responsibility for social insurance, in this case health insurance for old people between the workers, employers, and the government. In doing so these arrangements might enhance union strength as it gives companies welcome respite from an uncertain and growing liability.

Box 2: Why Americans Want Retiree Health Insurance: Retirement Income Insecurity

Reasonable people should fret over their retirements' financial future. The Securities and Exchange Commission predicts that boomers – workers aged 45 – 60 in 2007 will have poverty rates over 20 percent when they retire and 45 percent of boomers will not replace at least 60% of retirement income. The Center for Retirement Research at Boston College predicts that over 40% of late boomers, born 1955 -- 1964, in the top third of the earnings distribution and 60% of workers at the bottom will not have enough retirement income to replace 70% of their pre-retirement income. And that doesn't even count what people will need for medical costs. Medicare pays, on average, for only half of all medical expenses. Health insurance premiums for a typical retired California public employee and his or her spouse are over \$700 (a month!).

Economist Larry Thompson predicts the average future worker's wages will grow by 32 percent, while future retirees' standard of living will fall 3 percent from 2003 to 2030 because Social Security benefits will fall. The main two reasons for this reversal in fortunes is that Social Security benefits are falling as the age at which people can collect full Social Security benefits rise. Two, rising Medicare premiums and out-of-pocket health care costs reduces disposable income of the retirees.

Though Social Security is the key source of pension income for most workers, and half the work force has a pension supplement, some help for retiree health expenses are vital to maintain a reasonable material standard of living after retirement.²⁹ And, having enough income in retirement matters. In fact, the celebrated increase in American's longevity is urged by rising retiree income and universal health insurance – Medicare.

²⁹ Social Security benefits replaces about 41 percent of income for retirees with average career earnings, over half to life-long-low earners, and 23% or less to those who have always earned more than the Social Security cap on taxable earnings. Retirees in the bottom 40% of the income distribution receive over 80% of their income from Social Security; retirees in the middle received over 60%.