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The Economics of Plant Closure

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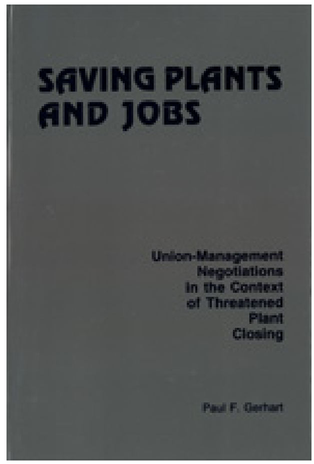

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The Economics of Plant Closure
Some Research Questions

The economist offers a simple answer to the question of why a particular plant closed—it was no longer profitable. A slightly more complex version is that the profitability of the plant fell below a minimal threshold level for the company so that an alternative investment of the capital embodied in the plant was preferable to continued operation. Such economic explanations are helpful in focusing on the problem, but they do not begin to answer the next question—*why* is the plant no longer profitable? Why is the plant "uncompetitive"? Why has it not been "modernized"? Why are labor or other factor costs higher than elsewhere, or why did demand fall? These questions require an institutional examination of the *ceterus* considered by economic theory to be *paribus.*

In particular, this study focuses on the labor factor and its relative importance in decisions to close plants. Other factors cannot be ignored and there is no intention in this study of sweeping them under the rug or suggesting that if all the labor factor issues could be resolved, plants would go on forever. Such a conclusion is simply not true. The labor factor has been identified as a key element in the competitiveness of particular areas, however, so it is fair to attempt an evaluation of the role of that factor despite a recognition that other factors affecting the viability of a particular plant may overwhelm the labor element.

Response to Change

Among the factors economists identify as contributors to a plant's decline is its inability to respond to external changes in product and factor markets or to internal opportunities for technological advancement.

Short-Run Changes in the Product Market

The simplest example of a need for change may be the case where new competitors erode the monopoly power of particular producers and force a decline in market price. To the extent that employees have shared in the monopoly rents (profits) with their employer, there will necessarily be a downward adjustment in labor costs, either through a more efficient utilization of labor or direct reduction of wages and benefits, if the plant is to survive. "Concession bargaining" demonstrates that downward adjustments are sometimes made. Such negotiations are always difficult, in part, for reasons outlined in figure 1.1. The following paragraph numbers correspond to the numbers in the Plant Closing Negotiation Model.

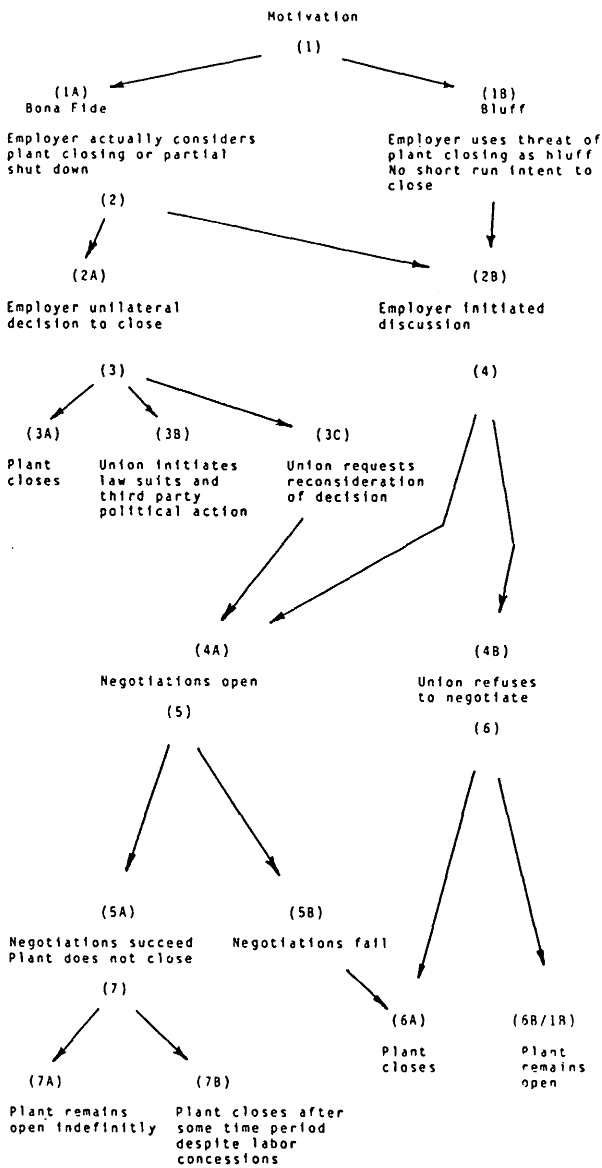
1. Two kinds of employer motivation give rise to the possibility of plant closing negotiations. A *bona fide* (1A) motivation is one where the employer actually considers closing for reasons which may or may not be related to the labor climate. Alternatively, an employer may use the threat of plant closing as a bluff (1B) in an effort to gain bargaining leverage.

To the external observer, including union leaders, distinguishing between these two motivations may be difficult. Many employees believed during the recession of the early 1980s that their company was taking advantage of the economic times. With other plants closing, however, any threat had to be taken seriously.[1] The appropriate response is obviously different in the two situations. A wrong conclusion—for example, that (1B) exists when in fact (1A) is the case—may be fatal. How do unions distinguish? Are they now aware of mistakes they have made in the past?

2. Given that an employer has a *bona fide* motivation, it may proceed with an analysis of its operations, make a firm decision to close its facilities, and then announce this decision to its employees and their union (2A); or the employer may raise the matter for discussion with its employees, perhaps by suggesting areas where labor cost considerations have a bearing on its closing decision (2B). When does an employer initiate such discussions? Why? Under what circumstances does the employer simply make the decision with no attempt to adjust labor cost factors through discussions with the union?

2.1. The Supreme Court, federal circuit courts, and the National Labor Relations Board (NLRB) have issued a number of decisions concerning the employer's legal obligation to negotiate when a decision is made to subcontract, close down facilities completely, or partially shut down facilities. In *First National Maintenance*[2], The Supreme Court determined that a firm was obligated to negotiate the impact or effect of its

Figure 1
Plant Closing Negotiations Model



decision to reduce its operations, but not to negotiate with respect to the actual decision. In 1981, the International Union of Electrical Workers sued Singer for closing a plant in Newark, New Jersey. Pantry Pride was also sued by its unions in Baltimore after the company closed a number of stores.[3] Does a legal requirement to negotiate, or the threat of legal action, enhance the likelihood of success in saving jobs?

2.2. When an employer has had difficult labor-management relations and has generally faced a union the employer feels is recalcitrant and uncompromising, does that employer seek to avoid any contact with the union and thus minimize the unpleasantness that is involved in the plant closing decision? The employer may expect that the longer the union is kept ignorant, the less harm the union can create. In short, what, if anything, motivates an employer to conceal a plant closure decision?

2.3. The employer who raises the issue of possible plant closing for discussion may do so out of a hope that concessions might be made or out of a loyalty to long-term employees and a concern for their well-being. What motivates an employer to raise the matter of plant closing is a critical question, because unless the employer raises the issue in a timely manner and offers to discuss it, there is a reduced likelihood that anything can be done to save the plant.

3. When an employer makes a unilateral decision to close, union leaders may not respond at all (3A); they may respond by initiating law suits or other third party political action designed to forestall the closing (3B); or they may request that the company reconsider its decision and offer to discuss some of the labor cost aspects associated with it (3C). The 3B and 3C responses may of course be combined where union leaders are merely using the 3B response to gain leverage in the 3C negotiations. Why is there no union response sometimes? Is it a lack of interest or expertise to deal with the issues? Do leaders view the situation as a lost cause? Do general labor market conditions affect their response? How do leaders decide between 3B or 3C when they take action? Is 3C the response most likely to yield success—to keep the plant open indefinitely? If it is, how can union leaders be encouraged to take that alternative? What prevents their taking that approach?

4. Union response to an employer-initiated discussion is likely to be motivated by the same considerations as a response to a unilateral employer decision to close. Research questions 3 and 4 are, therefore, closely related though not identical.

When an employer initiates a discussion of labor costs, union leader reaction may be favorable so that negotiations are undertaken (4A), or negative so that no discussions are undertaken (4B). The employer initiative might also be treated in a perfunctory way so that no real negotiations occur. Union leaders may take a negative position on reopening negotiations for strategic reasons related to the union's position in other bargaining units. For example, a refusal to meet might be motivated by concern for the pattern-setting effect any concessions might have. How important is this motive as a bar to negotiations on labor cost factors?

5. Perhaps the most important question in this study is what distinguishes successful (5A) from unsuccessful (5B) negotiations, once the parties are at the table. Successful negotiations are, of course, defined as those which maintain the plant.[4] When talks fail, is there generally a miscalculation on the part of the union concerning employer motivation (1A versus 1B)? That is, does the union conclude that the employer is bluffing when it is not? What other factors contribute to the failure of talks? What are the factors which lead to successful talks? Is it expertise and knowledge on the part of union negotiators concerning the economics of the situation the plant faces? When do employers or unions take a hard line in negotiations? Are their positions solely dependent on economic factors, or are leadership styles, personality variables, or other "nonrational" issues important to the outcome?

6. Where a union refuses to negotiate after a request from the employer (4B), either the employer closes the plant (6A) or the plant remains open (6B). When the latter happens, is it always safe to assume the employer was bluffing?

7. Finally, with respect to figure 1.1, is there a distinction between plants which remain open indefinitely (7A) and those which subsequently close anyway (7B), even though substantial labor cost concessions have been granted? Is it true that once concessions are requested it is usually too late to save the plant? Many union negotiators are not convinced that concessions save plants.[5]

Long-Run Changes—a "Tragedy Scenario"[6]

One model for an Elizabethan tragedy calls for the introduction of the hero's dilemma in the first and second acts, a set of events leading to a climax (the "handwriting on the wall") in the third act, and the playing out of the inevitable tragic conclusion in the fourth and fifth acts. Even though this model may reflect poetic license, and not a very good fit with the actual plays of Shakespeare, it does describe a pattern that applies to some production facilities in Cleveland.

Perhaps as long as 30 years before a particular plant is closed, corporate planners are called upon to expand facilities for increased output or new product lines. At that point in time, a decision is made to begin operations at an altogether new location. A variety of reasons is given for choosing a new location rather than expanding at the existing plant. Typically, they include availability of space at much lower cost, proximity to new or expanding markets or to suppliers, and occasionally matters related to labor and human resources. Avoidance of a militant union might be a factor, but this is often offset by the lack of a trained or trainable labor force, particularly in industries where there is special reliance on experienced or skilled workers.

Though it was not intended and never recognized as such, the decision to expand production in an entirely new location may be the climax of Act III. It is not part of a conscious 25-30 year long-term policy to relocate the corporation to the Sun Belt, but it is the decision that determines the eventual fate of the older original plant location. Once a plant is established in a new location, expansion of that facility is often easier than at the old location because planners have anticipated such needs and purchased extra land in the initial new construction. After several years, productivity and labor costs in the new plant are more favorable than in the old plant because the newer plant was built and equipped with the latest technology. As one union interviewee on this project noted, "If they gave us the equipment those guys down South have, we could make [product] twice as good as they do and twice as fast! With the junk we have to work with it's a wonder we get anything out of this plant."

When the inevitable recession occurs, production cutbacks are ordinarily scheduled for plants with the highest costs and lowest rates of productivity. If production is permanently reduced, "consolidation" or "rationalization" of production is concentrated into the more productive plants. Over a period of years, with successive expansions and contractions, the inevitable decision is made to close the old site completely. The only way to reverse such a process is via a new decision, sometime prior to the ultimate phase-out, to introduce new products or technology into the old plant. Such a decision can be made only when relative cost advantages dictate it.

Need for continuous change. In the long run, all markets change. Consumer tastes, customer needs, factor markets, and technological changes combine to assure that practically no product has an infinite life. In many plants, the products produced and the technology in use change, thus extending the life of the plant. In some plants, they do not. In view of limited product life cycles, change is the *sine qua non* for remaining viable. Part of the explanation for differences among plants is the perception on the part of management concerning the ease with which change could be introduced. A labor force that is thought to be rigid or unwilling to accept change would clearly stand as a "cost" in the evaluation of whether change should be introduced. Such a cost is just as surely an element in plant closing as "excessive wages." In fact, it may be a more serious issue because its effects are insidious and irreversible after some crucial point.

In this study, an attempt has been made to evaluate the relative importance of "labor force rigidity" as a factor contributing to the failure to introduce timely investment that could preserve plants and jobs. The research question is to what extent employee or union rigidity inhibits or eliminates the flexibility that is necessary to sustain a plant. Anticipating some of the study's findings, this question has been expanded to look into the extent to which unions actually seek or pursue change in product mix or technology in an effort to assure job security.

Greenfields closer to home. A good strategy for averting the tragedy scenario altogether was demonstrated in two cases reported in chapter 4. Instead of relocating a new facility to an altogether different area of the country, new "greenfield" plants were built in close proximity (easy commuting distance) to the existing plant. New technologies and the scope of the expansion projects demanded new plants, but contrary to the usual tragedy scenario, these plants were built nearby, despite the fact that more distant locations were seriously considered by management. Union leaders were called upon to make contract modifications to accommodate the new plants, not only with respect to the conditions and benefits of the yet-to-be-hired employees, but also for existing employees.

Why do some union leaders comprehend the importance of plant location decisions and make the effort to influence them? When does management recognize the possibility of improving its *overall* relationship with the union and take the risk of negotiating a matter that is clearly beyond the purview of the NLRA's mandatory scope of bargaining? What factors contribute to the successful conclusion of such negotiations?

Personalities and "Politics"

Rank-and-file resistance and union politics have also been cited as a key factor in determining the success of negotiations when employers ask for concessions. Such considerations may determine whether path 4A or 4B is followed in figure 1.1. Thomas Miner, vice-president of labor relations for Chrysler was quoted recently on this. "Industry's problems at the bargaining table are not now with union leadership, but with the rank-and-file."[7]

The leadership on both sides of the labor-management relationship appears to play crucial roles in determining whether particular plants survive. Even leaders with Messianic traits cannot step into a situation that lacks economic viability and save it. As noted above, this study is not about such situations. Rather, this research question concerns plants that appear to be economically viable, but ineffective leadership causes premature closure. More broadly, the research question relates to the importance of leadership and other noneconomic elements in determining whether plants close prematurely. Why is it that union members vote to reject concessions despite the fact that job loss will follow? Why does such behavior, which appears irrational from an economic standpoint, occur?

Summary

An underlying premise in this study has been that plants that have lost their economic viability will be closed. No heroic effort will save them. Many plants close prematurely, however. The most visible situation involving premature closure is one where relatively short-run changes in product market competition erode the monopoly rents of an employer and require the downward adjustment of wages. Convincing a union, and more important its constituents, that such adjustments are necessary, is the crucial step in saving a plant in this situation. How does that process work?

Cases where longer term change has not been accommodated are less visible. That is, the closure seems inevitable when it occurs, but to those who review the situation carefully, it is evident that actions could have been taken to extend the life of the plant had they been undertaken early enough. New products and investment in new processes are crucial throughout a plant's life. The key question here is why such actions were not taken in a timely fashion.

Finally, noneconomic contributing elements cannot be dismissed. How important are they in situations where potentially viable plants fail? Are there systematic explanations for the failure of interpersonal or political relationships?

The following chapters provide case examples that illustrate some of the issues raised in this chapter. They provide partial and tentative answers for some of the questions. Some readers will disagree with the conclusions reported here. It is hoped that they will be inspired to offer their own conclusions or, better still, engage in their own research to better address the issues involved.

The usual caveat regarding the usefulness of case studies must be entered. They raise more questions than they answer in any definitive way.

NOTES

1. *Wall Street Journal,* October 13, 1982, p. 1.

2. *First National Maintenance Corporation v. National Labor Relations Board,* 452 US, 666 (1981).

3. *Wall Street Journal,* October 13, 1982, p. 16.

4. In the context of the "Tragedy Scenario" (see next section), even a partial shutdown could be seen as a failure of plant saving negotiations. Where plants are partially saved, however, there is still a chance for a "comeback" so each case of a partial shutdown or retention must be judged individually as to whether negotiations were a success.

5. *Wall Street Journal,* October 13, 1982, p. 16.

6. Thanks are due to Tommy McQuistion, former vice-president of Parker Hannifin and executive-in-residence at the Weatherhead School of Management, 1982-83, for first calling the pattern described in this section to the author's attention.

7. *Labor Relations Reporter, News and Background Information,* 112 LLR 326 (April 1983).