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### Subcontracting: Innovative Labor Strategies

Sue Helper

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## Subcontracting: Innovative Labor Strategies

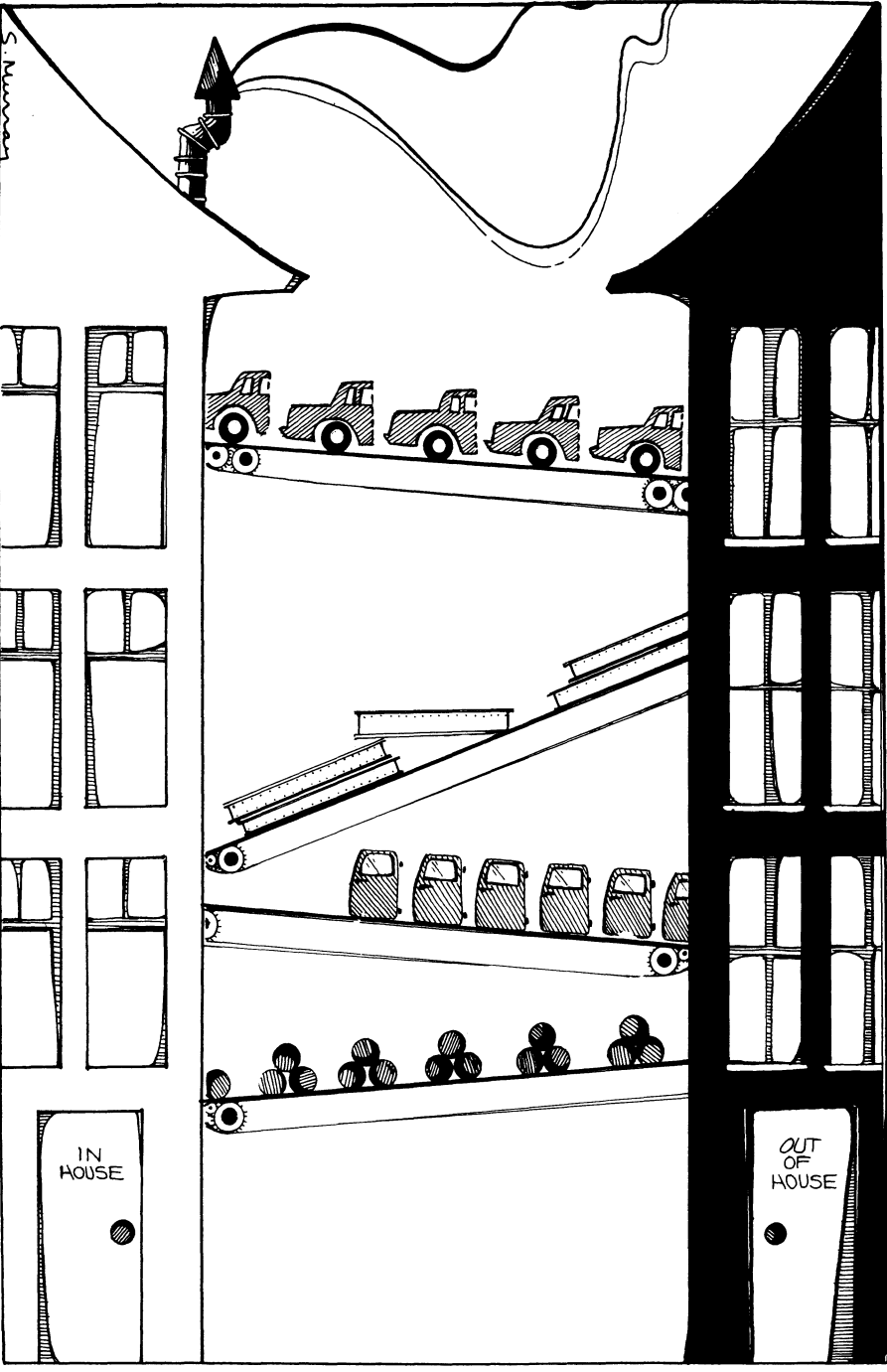
### Abstract

[Excerpt] Over the past 15 years, U.S. corporations have searched desperately for ways to turn back stiff foreign competition. One of their strategies has been subcontracting—letting work out to outside firms, so as to gain access to both better production techniques and cheaper, more docile labor. Responding to subcontracting will be one of the principal challenges facing labor in the 1990s. The impact of subcontracting has already been quite severe, particularly for unionized workers. Tens of thousands of workers have lost their jobs, and others have taken pay cuts. Unions are responding to this challenge by using both collective bargaining and public policy mechanisms. This article will focus on innovative efforts by two unions: the Steelworkers (USWA) and the Auto Workers (UAW). It is not surprising that both these examples come from heavy manufacturing, since this was the unionized sector first hit by foreign competition; other sectors have not been faced with the problem as severely until recently. Even though the circumstances may differ, workers in sectors as diverse as hospitals, telecommunications and airlines can learn from the auto and steel industry experience because in these industries, deregulation has intensified competition in much the same way that the rise of foreign competition has affected manufacturing.

### Keywords

USWA, UAW, strategy

S. Newman



IN  
HOUSE

OUT  
OF  
HOUSE

## Contracting Out In the Private Sector

# Subcontracting

## Innovative Labor Strategies

■ *Sue Helper*

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- Sue Helper, a member of the Dollars & Sense editorial collective, will be an assistant professor in the School of Management at Case Western Reserve University in Cleveland beginning in the Fall 1990 Term. For helpful discussions of this topic, Helper thanks David Bensman, Bruce Nissen, Sheri Antonacci, Ann Martin, Steve Herzenberg and Mike Gaffney.

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### **Why Firms Subcontract**

In the short-lived "American Century" between 1945 and 1975, oligopolistic firms like Ford, General Motors and US Steel, unchallenged either at home or abroad, became huge organizations with highly capital-intensive production processes. They were able to make profits with such high fixed costs only if they maintained a high rate of output. Disruptions to that rate of output, such as supply shortages, became the manufacturing executive's worst nightmare. Key to these firms' strategy for maintaining continuous operations was establishing direct control over all aspects of production, from raw material to finished product.

Manufacturing executives knew that supply disruptions could be caused not only by sloppy management at a supplier firm, but also by unhappy workers in their own plants. To avoid this possibility, they were willing to pay relatively high wages to workers throughout their vertically-integrated organizations in return for wide latitude in managing the shopfloor. Because most large corporations concluded that organized labor was a lesser evil than disruptive work stoppages, they usually did not oppose organizing drives in their plants.

While it lasted, Big Labor and Big Capital had a fairly convenient arrangement. Big Capital made large profits by controlling its markets, and Big Labor shared in some of those profits as the price of labor peace.

As U.S. corporations have become subject to foreign competition during the past two decades, they've responded with two strategies (or sometimes with combinations of the two). The first strategy, *innovation*, involves developing new techniques to cut costs or improve quality by increasing efficiency or "working smarter." The second strategy, *adaptation*, aims to cut costs using existing techniques—suppliers and workers do the same thing, only cheaper and faster. Both of these responses may involve subcontracting.

Innovation may lead corporations to use more outside suppliers for several reasons. First, as corporations strive to improve product quality, they find it necessary to pay stricter attention to detail than before. As a result, individual plants find they have to focus on just a few activities. For example, automotive assembly plants used to be responsible for assembling cars piece by piece; 5,000

separate parts came into the plant. This number was more than anyone could really pay attention to; minor problems were ignored in the interests of keeping the plant running. Now, the automakers are moving toward modularization—having components suppliers do some of the assembly themselves.

A second reason that corporations which have adopted the innovation strategy use more outside suppliers is that innovation may require the use of technologies that are not available in-house. In automobiles, for example, technology is changing in virtually every aspect of the product: electronic systems (such as electronic fuel injection) are replacing mechanical devices (such as carburetors); materials such as plastics, ceramics, and aluminum are replacing steel. One firm simply cannot keep up with all the technologies involved in making all the components of a car. Therefore, automakers are decentralizing. For example, Ford has given TRW Safety Systems responsibility for all safety devices on Ford cars: air bags and associated electronics, seat belts, etc. This arrangement allows Ford to focus on those matters in which it has the most expertise, such as design of the car, final assembly, and marketing.

A third reason that the innovation strategy leads corporations to choose outside suppliers is that in-house suppliers tend to take up too much scarce top management time—there is no way for corporate management to commit itself not to intervene in the affairs of its subsidiaries, and it is hard to distinguish a good intervention from a bad intervention ahead of time.

The adaptation strategy can also lead to subcontracting. Outside suppliers can often be found who will do what at least appears to be the same work for far less cost, due to their avoidance of union wages and work rules.

The adaptation strategy is likely to be profitable only in the short run, since there are limits to how far one can squeeze. However, it may be sufficiently profitable in the short run that it appeals to managers and stockholders who want to use the business as a cash cow, driving out the possibility of long-term improvement.

## **Collective Bargaining Responses to Subcontracting**

### **Restricting Outsourcing**

One approach to the problems caused by subcontracting for workers is to try to ban it outright. The USWA has used this strategy, with some success.

The USWA's contract is explicit: "the guiding principle is that work capable of being performed by bargaining unit employees

shall be performed by such employees." This statement is weakened by several conditions, but remains quite strong. The company must notify the union before any outsourcing occurs. If the union local thinks it has a case, it can ask for "expedited arbitration," which means that a board of arbiters is supposed to decide the case within 10 days; the work cannot be contracted out until the board has ruled.

The effectiveness of these provisions varies a great deal, depending on the degree of organization of the union local and the intransigence of management.

For example, Local 1010 in East Chicago, Indiana, a 10,000-member unit with a history of rank-and-file activism, has kept 300 jobs in-house as a result of the agreement. "We have eliminated the problem of contracting out; if we're capable of performing the work, we do it," declares local president Mike Mezo. The union's role has changed a great deal as a result of the agreement—30% of the staff (3 people) work full-time monitoring the agreement, and the union as a whole is much more involved in management. In what Mezo describes as "on-going war" with Inland Steel management, the union has forced the company to buy a \$600,000 milling machine and other equipment rather than contract out some work. "It drives them crazy to have union people making management decisions. They keep saying they want to co-manage the plant with us—but the only time they say that is after we force them to."

In contrast, Local 1014 at the Gary Works of USX has had even less cooperative management to work with, and lacks a history of the rank-and-file activism necessary to achieve the constant vigilance necessary to enforce the agreement. Paul Hashiguchi, the contracting-out chairman, filed 4,000 grievances himself in 1987 and again in 1988. (The number was down to 2,000 last year). First he had to fight a battle to get USX to notify him of plans to contract out. After many grievances over this issue, the company now notifies him, but so many of the company's practices violate the bargaining agreement that "expedited" arbitration takes three months instead of the normal ten days.

The proposed contract cannot be let until the arbiter has ruled, so USX's intransigence hampers its day-to-day operations and costs "millions and millions" in back pay. In contrast to Local 1010, Local 1014 has not had the luxury of fighting the company for new equipment; Hashiguchi is still trying to get USX to in-source work that was illegally outsourced between 1983 and 1986. Another battle is to get the company to hire new workers as volume increases and older workers retire, rather than use lack

of labor power as an excuse to subcontract.

### **Negotiating Income Security**

Another union strategy is to accept outsourcing, but to force employers to pay the costs of dislocating workers. This approach has been taken by the UAW in negotiating the Job Opportunity Bank-Security (JOBS) Program at the Big Three automakers.

Under this program, the number of active workers with more than a year's seniority in 1987 determined the initial "secured employment level" (SEL) for each plant. For every two slots opened by attrition, the SEL decreases by one. For every new worker hired or recalled from layoff after a certain number of weeks, the SEL increases by one. Except for reasons of declining volume, no worker with more than a year's seniority can be laid off if it puts the plant below its SEL.

If workers are not directly needed in production (due, for example, to subcontracting or technical change), they go into the JOBS Bank at full pay with no loss of seniority—at least until either the contract ends or the automakers' agreed-upon liability runs out. (GM's liability is \$1.3 billion for the 1987-90 contract.) In the JOBS Bank, employees may receive schooling or job training, substitute for another worker who is being trained, or receive a "non-traditional assignment," which could be investigating customer claims of poor quality or fixing up a park in the community. In addition, they can choose the Voluntary Termination of Employment Program (VTEP), in which they are paid a lump sum ranging from \$12,000 (for workers with 1-2 years' seniority) to \$65,000 (for those with more than 25 years).

A particularly heavy user of the JOBS Bank program has been the AC Rochester plant in Rochester, New York. This GM plant has been hard hit, first by the obsolescence of its product, carburetors. This change took away 1,132 jobs between October 1985 and February 1989; 379 more were lost due to productivity improvements and outsourcing. At first the local relied on the Jobs Bank program. 476 people retired under the VTEP program, and 259 left under other programs. By February 1990, 793 people (21% of total employment at the plant) were left in the Bank.

Local union officials call the JOBS Bank "a fantastic program." Not only has it averted massive layoffs, it has allowed people to gain new skills. Since the Bank began, 700 people have obtained their GED; others have received training in finance and cost estimation. Currently, 170 AC Rochester employees are full-time college students (two-thirds of whom are on the Dean's List). The Bank has provided the labor hours to allow the plant to take a



pro-active approach to health and safety issues, and to provide substance abuse and AIDS awareness programs. When salaried jobs become vacant, a JOBS Bank employee can fill in if qualified; for example, the plant used to hire a lot of temporary clerical help, but that practice has been eliminated.

However, having such a large number of people in the bank has had unanticipated consequences: equity issues are very difficult since there is no comparable program for salaried employees, and because low-seniority employees can jump directly from the Bank to prime first-shift jobs. Resolving these issues has taken a great deal of union and management time. A UAW newsletter proclaimed on March 1, 1989, "There is not a manufacturing plant in the world that is required to assign almost 800 people job assignments that are totally different from what these union members were hired to perform!! Think about it! The size of our Bank has become the focal point of all management and union discussions, decisions, and future direction."

Besides the administrative problems, the JOBS Bank provides "only income security, not job security," says Bill Dell, the UAW's joint program coordinator. If fewer active employees are needed due to a volume decrease, then people currently working will move to the JOBS Bank, and those in the Bank will be laid off. "While the JOBS Bank program has allowed us to do a lot of nifty stuff, until the people in the Bank have real jobs, we're not where we want to be."

### **Insourcing**

Because of the problems with the JOBS Bank, the AC Rochester local has adopted a strategy intermediate between the two extremes of trying to block subcontracting completely and of acquiescing in it as long as the company provides income security. This strategy leaves the final sourcing decision to management, but provides a mechanism for internal suppliers to bid to keep the work in-house. In this strategy, the union tries to convince management to join in what ex-UAW staffer Dan Luria calls a "productivity coalition." The goal is to increase (or at least maintain) both profits and wages by means of changes which reduce costs or improve revenues. To implement such a strategy, the union offers to trade relaxation of work rules, suggestions for improved operations, and sometimes wage concessions in return for guarantees of job security and increased investment by management.

At AC Rochester, the existence of the JOBS Bank has been key to the implementation of a productivity coalition. The protection

provided by the Bank led the union to agree in 1986 to combine job classifications, moving from 112 production classifications to about 20, and from six tooling trades to one. These changes have reduced costs by an estimated \$20 million. According to Dell, "Sometimes you have to give up 200 jobs to save 2,000. The alternative is to stay stuck in the mud until everyone drowns."

The existence of the JOBS Bank has provided the labor to analyze sources of inefficiency. Two years ago, an energy task force saved \$5 million in its first week. Almost all of the skilled workers have been trained in cost estimation, and internal shops now routinely get to bid on jobs which used to automatically go outside.

UAW Local 1097 has saved jobs at AC Rochester not only by reducing out-of-pocket costs, but by convincing management to follow the logic of their own arguments about the importance of quality improvement and inventory reduction. Management wanted to outsource deburring, but the union saved 80 jobs when it persuaded management that inventory reductions offset the higher cost of doing the job in-house. Another 30 jobs came back when a machining subcontractor had trouble meeting the production schedule.

In 1986, Local 1097 and AC Rochester established the Competitive Edge program, which uses worker suggestions and up to \$20 million in GM money to create new businesses. However, the program has had "minimal" success, according to Dell, "because GM insists that the investments pay back in a year or so—tough to do if you're starting a new venture. . . . If, as they say, people are our greatest resource, then why not bring work in even if it just breaks even? Our relationships are good with plant management. But, unfortunately, the people we talk with day to day can't cure our ills—local management doesn't have the authority to bring in a new product line, or even to spend \$100,000 for a machine."

### **What Should Unions Do?**

When a union is faced with a management decision to subcontract, which response should it choose? There is no single answer. Each of the three strategies outlined above—limiting subcontracting, negotiating income security, and insourcing—is appropriate in some situations and not others. It all depends on why management has decided to subcontract in the first place.

If management is primarily following an "adaptive" strategy, in pursuit of cheaper labor, it will be tough for the union to create a productivity coalition. This case is exemplified by USX, a

company which has so little commitment to steel that it has taken the word out of its name. In such a case, it is better for the union to try to block subcontracting (if it is strong enough).

The fight against subcontracting in steel is facilitated by the technical difficulties involved in splitting up different parts of the steelmaking process. In contrast, an automobile is made up of many easily separable parts. But technical difficulties will not stop a determined company from subcontracting. Since union victories in arbitration have made it hard for USX to bring subcontractors into plants to work, US Steel management in Gary has begun sending equipment out of the plant for maintenance—including huge items such as a transfer car, which is used for hauling iron ore and weighs as much as two locomotives. The moving process alone took one day and cost several thousand dollars, not including the cost of downtime.

However, it seems possible that if the union is strong enough, it will be able to show management the wisdom of "if you can't beat them, join them," especially if management is committed to staying in the business of producing high-quality products. At USWA Local 1010, the union's persistence on subcontracting has forced the issue higher in the organization, where there is somewhat more openness to the idea of a productivity coalition. Senior management has acknowledged that in some cases, keeping the work in-house has saved the company money. In addition, the union forced the company to keep open shops (such as a forge, a foundry, and a motor shop) during a period of what local president Mezo calls "panic de-industrialization," when other firms closed theirs. These operations are now profitable since they take in work from companies that closed their shops.

If management is willing to consider innovative approaches to regaining competitiveness, then a productivity coalition may be feasible, as at AC Rochester. This union strategy is tricky to implement, however, because it requires continuous re-evaluation: When is it better to accept the loss of work than to make concessions? Is this concession really necessary to make the company competitive? Is a given change in work practices (such as a combination of trades) really a more efficient way of doing things, or is it just a clever form of exploitation which has large hidden costs (such as reduced safety due to reduced worker training)? If a union local does not carefully weigh the costs and benefits of each concession, and is not in close contact with other locals, a productivity coalition can degenerate into union participation in management's adaptation strategy. While such a tactic may at times benefit an individual plant, it will facilitate management's efforts

to play one plant against another, thus weakening the unionized sector as a whole.

Some union practices will improve the effectiveness of all three strategies. First, unions need to become more involved in management. Greater knowledge of the sources of costs and revenues obviously helps in designing and implementing productivity coalitions. But (somewhat to their surprise) unions pursuing the other two strategies have also found themselves deeply enmeshed in what traditionally has been management territory: participating in contracting decisions in the case of attempts to prevent subcontracting, participating in workforce assignments in the case of job banking.

Second, unions need greater rank-and-file involvement, to come up with suggestions for improved productivity, and to alert union officers of management's use of outside personnel in violation of the contract. The USWA contract facilitates such rank-and-file activism, because the back pay awarded for contract violations goes directly to the affected workers.

Thirdly, the fight against subcontracting requires unions to become effective leaders of their members on the shopfloor. To the extent that U.S. employers emphasize quality and just-in-time production, workers will gain new power through their ability to work together to perform smoothly a sequence of tasks that are not individually complicated, but which require teamwork. If unions can harness the skills of these teams, rather than allow management to control them, they can gain new leverage in collective bargaining.

### **Public Policy Responses to Subcontracting**

Even if unions learn both to become more adept at management tasks and to mobilize the rank and file, their ability to mitigate the effects of subcontracting will depend on their ability to change public policy as well. As the USWA and UAW have recognized, the effectiveness of each of the three collective-bargaining strategies outlined above is significantly influenced by the political environment.

Unions are using two basic political strategies. First, they have lobbied for quotas and "voluntary export agreements" to limit the foreign competition which provided the impetus for subcontracting. This strategy is becoming less and less effective against subcontracting in the auto industry because it doesn't prevent foreign firms from setting up new, nonunion plants in the United States (although it does put limits on firms' ability to use super low-wage

labor abroad).

The UAW has also proposed, with less success, measures to put new and old plants on a level playing field by stopping states from trying to outbid each other with subsidies to win new plants, and by socializing pension and health-care costs, which are far greater for older plants.

The second political strategy is to try to reduce the benefits of subcontracting directly. A recent example is the passage of legislation requiring advance notification for plant closings. The UAW is also working to strengthen the technical base of heavily-unionized areas. It is doing this by working with state agencies such as the Michigan Modernization Service and the state of New York, and university-based projects such as the Programs for Employment and Workplace Systems at Cornell.

These political efforts increase the effectiveness of the collective bargaining strategies. To the extent that subcontracting is made more expensive (because companies are forced to pay more of the social costs of their actions) or in-house operations become more productive (through training programs), management has less incentive to violate agreements blocking subcontracting, and a productivity coalition has more of a chance to develop.

## **Conclusion**

Unions are adopting three collective bargaining strategies for limiting the impact of subcontracting. The Steelworkers have pioneered with negotiated limits on outsourcing. The UAW has developed elaborate programs to provide income security. And some union locals are joining "productivity coalitions" to win work that management might otherwise outsource.

Which strategy should a local union choose? Unions' overall goal should be to take workers' standard of living out of competition. When management is following an innovation strategy, trying to become more competitive by improving product quality and efficiency, unions should not aim to prohibit subcontracting for three reasons. First, management is unlikely to agree to this. Second, to the extent it does agree, efficiency is hurt, and long-term job preservation is jeopardized. Finally, and most importantly, it makes unions look like a special-interest group—which hinders the development of the coalitions necessary for the political strategy to succeed. In particular, unions should not try to block subcontracting to other union firms.

Unions should aim to protect workers from the effects of stupid or self-interested management, however. That is, they should try

to stop subcontracting of the adaptive variety.

Labor political action to make subcontracting less profitable is an essential component of any collective bargaining strategy.

Finally, organizing nonunion subcontractors would go a long way to solving the problem, though it's easier said than done. The UAW's recent commitment to step up organizing of nonunion shops is an important step in the right direction. ■

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The distinction between *innovation* and *adaptation* strategies is developed in William Lazonick, *Business Organization and the Myth of the Market Economy* (Cambridge University Press, 1990). Other particularly useful sources for subjects discussed in this article are: Sheldon Friedman and Lydia Fischer, "Collective Bargaining and Employment Security," *IRRA 41st Annual Proceedings, 1989*; Candace Howes, "The Future is Now and It's All Going Wrong: Automotive Restructuring and the Cost of Maturity," UAW Research Department, April 1989; Daniel Luria, "New Labor-Management Models from Detroit?" *Harvard Business Review*, Sept.-Oct. 1986; and Sally Klingel and Ann Martin, eds. *A Fighting Chance: New Strategies to Save Jobs and Reduce Costs* (Cornell University ILR Press, 1988.)