The Micro Solution

The battle to regain America's competitiveness must be won in the corporate office and on the shop floor, not in Washington, according to Atlanta Fed Research Director Donald Koch.

How does a great nation find its way once it has wandered off the track? The United States has reason to ponder that question in September 1983, as we consider the multitude of problems—many of them economic—confronting us.

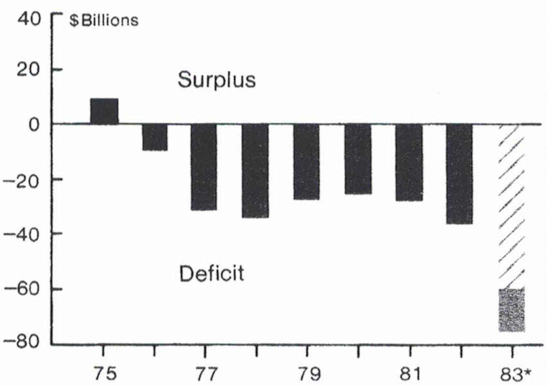
We were a favored land at the end of World War II. The war, tragic though it was to many Americans, had helped mobilize our physically unscarred nation into the greatest industrial machine in the history of man. We were characterized, and accurately so, as the world's assembly line. Our products were cherished around the globe, from our stylish fashions to our marvelous electrical gadgetry and our sleek chromed automobiles. Our productivity was the envy of less-blessed nations, our managements the most professional, our plants the most modern.

But beginning in the 1960s, during that turbulent era of Vietnam and flower children and urban rioting, we seem to have lost our national sense of direction. Things began to go wrong with the very factors that had made our industries proudest. Our vaunted productivity, our reputation for management expertise and those plants that had seemed so advanced to a post-war world, all seemed to lose ground through the 1970s.

If you want to take a nostalgia trip, try to remember back to when we used to joke about the quality of goods bearing the label, "Made in Japan." We used to have a lot of fun with the Japanese, who during the 1950s acquired a reputation for cheap merchandise that drew absolute scorn from American business people and consumers alike.

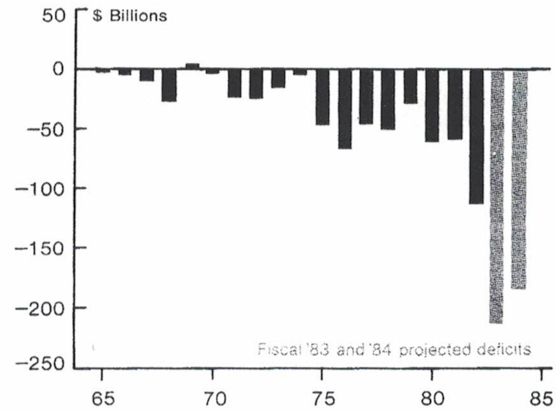
But, in what seemed to be an abrupt about-face, we have seen the roles played by the United States and Japan reversed. Suddenly, we are the ones defending the quality of our products. Our own consumers have become our companies' harshest critics, judging from the way

Chart 1. U. S. Merchandise Trade Balance of Payments



Source U.S. Dept. of Commerce
*Projected by government and private forecasters

Chart 2. Federal Budget Deficits



Source: Office of Management and Budget

they have deserted American-made products ranging from watches to apparel and television sets.

Similarly, foreign buyers are purchasing fewer of our goods in global markets today, except for specialized areas that we continue to dominate such as food and defense products. America's competitive decline is reflected in the fact that our growth has been slower than that of our trading partners for the past decade. Even as we accumulate huge balance-of-trade deficits—expected to reach $60-$75 billion this year—we are rolling up record deficits in our federal budget. The latest estimates warn that we face an appalling deficit in excess of $200 billion this fiscal year (Charts 1 and 2).

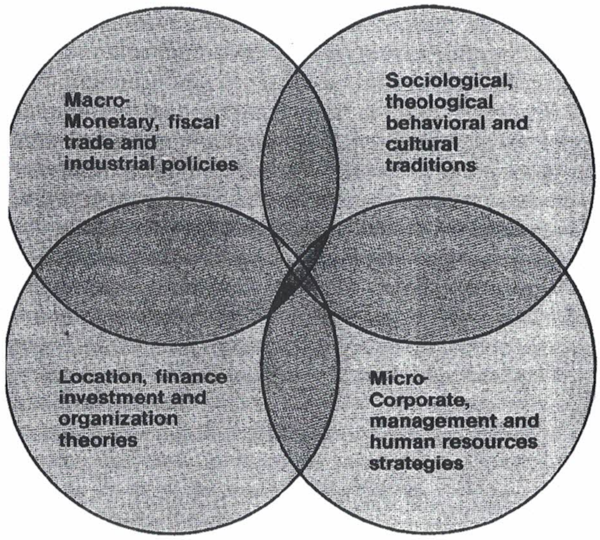
More bad news? Our investment rate, crucial to our ability to rejuvenate our plants and equipment, remains lower as a percentage of gross domestic product than most of our trading partners. Our savings rate ranks the lowest among the industrialized nations—pretty bad for the society that produced Benjamin Franklin and a dedication to thriftiness. Our industrial production slumped 8.1 percent last year, and our gross national product declined by 1.9 percent, figuring at constant 1972 prices.

Unemployment, though edging downward as the recession fades, still remains high with around 10.6 million Americans out of work. And although inflation has slowed dramatically over the past couple of years, it still must be considered a sleeping monster that may waken to surprise us if we don't remain alert.

How do we as a nation address such problems and find solutions to what adds up to a sobering dilemma? Are the solutions macro? Can we resolve our problems by tinkering with monetary and fiscal policy, trade policy and industrial policy? Can we do it, for instance, through monetary policy—by fine-tuning the way we manage the money supply seeking to achieve low inflation and stable employment? Are the solutions structural? Or are the solutions micro, carried out on the factory floor rather than on Capitol Hill? There is persuasive evidence that the latter comes closer to the mark—that micro solutions offer our greatest hope—and we'll address that later. But first, let's look at a schism among professionals that has helped divert us from adopting a national approach to tackling our problems. Economists, as well as other professionals, must bear a share of the blame for delaying that solution.

Each profession, it seems, has viewed our national malaise only in terms of its particular discipline. Each identifies our dilemma in terms of its own expertise. The theologians, for instance, see the problem as growing from a cultural decline of cherished values. Ethical scholars fear that we have lost our adherence to principles, that we respond too much in a situational manner. Behavioralists, on the other hand, think our culture has lost its ability to adapt to change. Finance specialists? They speak of it as a problem of underinvestment — failure by industry to reinvest enough capital to renew our creative and productive capability. Business scholars see

Chart 3. Possible Solutions



it as an organizational problem that calls for a restructuring to maximize output. Security analysts often speak of it as a locational problem, arguing that it doesn't make sense to build cars in Detroit if you can build them in Tennessee at a lower labor cost. And we economists like to dwell on the importance of macro policy—of achieving enlightened monetary policy or trade policy.

Unfortunately, while each of these professional areas is focused on seeking solutions, the different disciplines seldom talk to each other to share perspectives. They even seem polarized, jealous of their own turf and suspicious of encroachment by intruders. As a result, our vast nation, with its awesome problem-solving capacity, finds itself starving for answers because there simply isn't enough integration of information. And information, as history shows us, tends to be cumulative. Therefore, we find our society striking back with overengineered solutions that further compartmentalize the problems, rather than adopting a holistic solution broad enough to encompass them in their entirety.

What are the problems that we must address? Let's touch on some major ones.

First, there's the question of American productivity, once the world's model. Our productivity remains the world's highest, but our standing says more about past achievements than about recent performance. We registered the smallest manufacturing productivity increase among the major nations between 1977 and 1982—a mere 4 percent, based on output per man hour. By contrast, Japan's manufacturing productivity soared about 28 percent over that period—suggesting why American comedians don't poke fun at our friendly rivals these days.

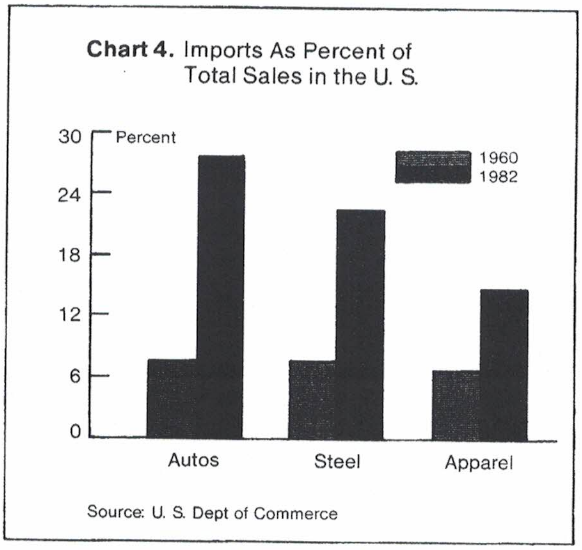
Our savings rate also has become an embarrassment. We've been saving only about 6 percent of our earnings each year, the poorest rate of any industrialized nation. The Japanese, with a financial and economic climate that encourages the highest personal savings rate in the world, boast a 1983 rate exceeding 18 percent, three times as high as ours.

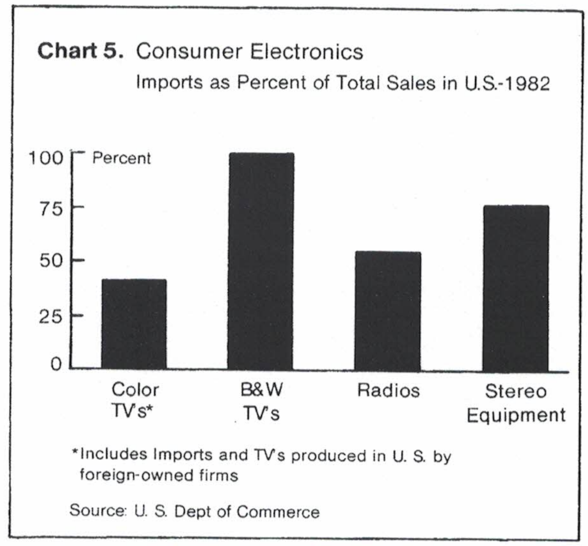
We can blame our low savings rate on a number of factors. Inflation discourages savings, of course, and so do illogical taxing policies that reward people who spend and punish those who save. As individuals, we must share the blame because of our penchant for consumption. But whatever the factors are, we find that we as a nation are left with less to channel into productive new plants and equipment.

Those federal budget deficits also have eroded our investment pool, forcing corporations to bid against the U.S. Treasury for investment dollars. Consider that our federal budget deficit, which seems likely to approach $210 billion this fiscal year, now represents fully 6 percent of our gross national product.

Our trade deficits are a bit scary too, although the pattern has been repeated so often now that we are becoming hardened to the annual report that our trading partners have outperformed us. This year we appear hell-bent toward a record deficit as a flood of foreign merchandise pours onto our showrooms and department store shelves. Ironically, our recently strengthening dollar has become something of a competitive liability in world trade. But what is most sobering is that our competitors no longer rely on low prices to undercut our products; more and more often, they beat us in the world marketplace by offering products that corporate and private consumers perceive as being superior to our own.

"Our vast nation, with its awesome problem-solving capacity, finds itself starving for answers because there simply isn't enough integration of information."





Not only are those foreign products cutting into our foreign markets, where our exports have declined from a 15 percent share in 1965 to a dismal 11 percent, but, with increasing frequency, foreign manufacturers selling everything from shoes and shirts to steel and electronic appliances to TVs are taking larger shares of our own domestic markets (Chart 4).

Troubled Industries

Automobiles, of course, offer a glaring example of this. A colleague recently noted a bumper sticker on an American car that read, "Imports are Hazardous to America's Health." He did a quick count and noted that the next six cars in line behind that protester had been assembled in foreign factories. If that bumper sticker is correct—and there certainly is cause to fear that it is—our economic health indeed appears to be in trouble! In fact, it's been estimated that foreign car sales in this country contributed to the indefinite layoff of more than 300,000 auto workers in 1982. Many Japanese cars, of course, are cheaper than domestic models, partly because it takes the Japanese about 100 hours to make a car, versus 175 hours for a typical U.S. car.*

*An estimate by Martin Anderson, executive officer of MIT's "Future of the Automobile" program, cited in **Fortune**, August 1983, p. 22.

The auto industry has launched a major effort to regain sales by improving both the efficiency of its plants and the quality of its vehicles. Industry executives also are enlisting the aid of their workers and their union representatives in a campaign to reestablish the industry's reputation for workmanship, which has been pretty badly tarnished. We will return later to the theme of enlisting employees as part of the solution process, an effort that appears to be crucial if we are to achieve an industrial renaissance.

While such industries begin to face up to their weaknesses, there is a real danger that our knee-jerk reaction may be to seek protection rather than to seek improved quality. Such protectionism could trigger a new round of trade wars like those that aggravated the Depression of the 1930s. It's distressing that we are hearing appeals for protection from such industries as textiles and apparel. Yet it's not surprising. Those firms, whose aging mills have been notoriously labor intensive, have watched foreign competitors bore steadily into their U.S. markets. If current penetration levels continue, imports could claim as much as 40 percent of our total textile and apparel market by 1990.

Another deeply worried sector is steel, one of the prized "smokestack" industries that stoked our nation into a superpower. Only recently, President Reagan imposed new restrictions on specialty steel imports from Europe in an effort to aid the domestic industry. Steel imports have grown from a mere 5 percent of our domestic market in 1960 to 22 percent in 1982.

What's more, a combination of foreign imports and after-shocks from our recent recessions increased the number of unemployed steelworkers to a peak of 165,000 in late 1982. Furthermore, big American steel firms have moved to diversify into other areas, such as finance, banking and consumer products, rather than develop new processes to make our steel more competitive.

In another area, imports have grown to represent a large share of our domestic consumer electronic markets (Chart 5). More than half of the radios and stereo equipment sold in this country are imported models, and it is virtually impossible to find a black and white television set made in America.

We have all heard the argument that many of these hard-pressed U.S. industries have just cause to seek protection—that they have been victimized by a collaboration of foreign governments and foreign industries. Some endangered U.S. industries have gone to court or have sought Commerce Department assistance because they say certain foreign governments and industries raid our markets while closing their own; that foreign governments shelter their national producers through a host of protectionist tactics including non-tariff barriers. Certainly our government must work aggressively through diplomacy to tear down any unfair barriers erected by the Japanese—or any other foreign nation—that deny our companies the right to compete without discrimination in their markets.

But will diplomacy solve our problems? Not when even our own consumers snap up foreign merchandise rather than buy American-made goods. Diplomacy can no more cure our national ills than a group of lawyers in Washington can solve our problems by legislating change. In fact, many of us believe that we may have too many lawyers and that their penchant for litigation has contributed to our problems.

None of this should suggest that macro policies aren't vital to this nation's economic health. Certainly we must look at such things as fiscal policy, which our massive deficits suggest needs some corrective action. Our trade policies need to be scrutinized carefully; should we, for instance, try to manipulate the dollar to force its value down vis-a-vis other national currencies and thus make our goods more attractive to purchasers overseas? And clearly we must look at the need for an industrial policy—do we, as some have advocated, try to redevelop the Rust Bowl? Do we invest millions attempting to reinvigorate the Detroits of our nation, trying to restore our auto and steel industries to world dominance? Many economists are skeptical of such a nostalgia-based industrial policy; they feel that such a policy would tend to support the losers at the expense of the winners.

We cannot discount the importance of such macro issues. They too must play a role in the ultimate response to our national challenges. But most observers would agree that there has been a continuing, full-blown national dialogue on monetary and fiscal policy. If we are lacking something, it is not verbiage on those subjects!

Rather, we have failed to focus on the details. And successful corporations and successful nations alike are those that concentrate on the operating details. What has created great American firms in the past is a willingness to pay attention to their knitting. By focusing on detail and staying true to their principles, superior companies have been able to achieve outstanding performance in revenues and profits, and to continue that performance through the years, even through recessions and changes in top management. They have a vision and they have a mandate because their people —and we may include either a company's employees or a nation's citizens in this category— feel an ownership that makes the relationship important to them.

"Diplomacy can no more cure our national ills than a group of lawyers in Washington can solve our problems by legislating change."

Management itself often has proved a hindrance in improving corporate performance. Consider management's frequent arrogance, its conviction that all answers must come from the top down and that solutions seldom rise from the bottom up. That probably is true. But it is true only because management rarely solicits answers from its troops on the front lines—and, because of management's arrogance, seldom can it convince those troops that their suggestions will receive a fair hearing even if they submit them.

Maybe the vast schism between American executive salaries and workers' pay has contributed to management's royal view of their corporate domains. It is interesting that an American chief executive officer customarily earns 40 times as much as a worker in one of his plants—perhaps drawing $600,000 a year while the worker may start at $15,000 or less. In Japan, that salary coefficient is only half as great, something like 20 to 1 for the largest companies.

We're just beginning to see corporate managements and workers taking the first tentative steps toward meaningful cooperation after years of virtual warfare over the bargaining table. The recent economic slowdown prompted labor unions to hold the line or even cut back pay scales in some industries, or to give back other benefits won in the past. And we've seen managements take a new interest in the opinions of their employees, in some cases for the first time in a decade or more. We have seen the "quality circles" concept spread, giving workers a rare opportunity to participate in the corporate problem-solving process. What a contrast with the pre-recession era! Some executives considered themselves egalitarian if they so much as posted a suggestion box where employees could volunteer ideas —knowing full well that the ideas usually were doomed to be ignored because they didn't come from the management side of the organizational chart. Our old-fashioned negative definition of quality too often resulted in products that were "just barely" acceptable. The quality circles, on the other hand, promote pride in workmanship and a thorough knowledge of the final product.

Concessions won or surrendered under the pressure of recessions and plummeting earnings are a unique situation, however. They aren't necessarily representative of a born-again commitment to corporate enlightenment. It will be interesting to see what happens to wage demands and to executives' cooperative spirit now that we have weathered the recession and companies are looking foward to better times. Prosperity, it seems, poses a far greater challenge to corporate cooperation than does recession.

If we are to establish a new commitment that endures through all economic seasons, we need to revisit the idea of working together so we can be unified in strength. For too long, our corporate staffs have been polarized and fragmented. We cannot have the engineers segregated away in an ivory tower engineering things, the workers on the factory floor making things, the managers off somewhere else issuing instructions and the corporate chieftans isolated from those activities in their air-conditioned executive offices. That kind of formalized, pyramidal organizational structure just doesn't make sense in an era when workers' input can make the difference between a corporation's success and its failure.

When we speak of recognizing employees' contributions, an important question of perspective is involved. Managements shouldn't patronize their workers to make them THINK that they count, but should provide them a legitimate opportunity to contribute to the decision-making process. We have every reason to believe that employees can contribute more to their employers' success than simply performing routine assembly line chores that a robot probably could execute as well.

Executives need to spend more time in their plants, sharing ideas and perspectives with blue-collar and white-collar workers who are closer to the operation than an officer can ever be. Officers should relish the opportunity to get a close-up look at the production process that they never could find time for when they were chasing an MBA. Engineers also need to be on the shop floor, close to the equipment that they designed or that they maintain, watching it demonstrate its strengths and weaknesses as it turns out products for real-world buyers.

"If we are to establish a new commitment that endures through all economic seasons, we need to revisit the idea of working together so we can be unified in strength."

We need corporations where workers on the assembly line don't think, "This is his problem" or "that is her problem"; rather, employees should think, "This is OUR problem." Certainly it is vital that we go through a consensus process to arrive at a solution quickly because all of our jobs are at stake. This is a new way of looking at problems—it is much more organic, much more behavioral, much more micro—and it involves searching for internal answers, not waiting for a ready-made, all-purpose hand-me-down solution from the executive suite —or from Washington.

Companies love to boast in their annual report about how valuable their employees are to them. Publicists snap colorful photographs of smiling workers on the job and write complimentary blurbs about their importance. Unfortunately, once the photographers have left the shop, a lot of firms tell the workers to march back to their desks, or to their stations, and get on with their work.

Despite our lip service to the idea that employees are valuable, it appears that we still have a lot to learn about training and utilizing people. Maybe we can even learn a lot from the Japanese. They learned from excellent teachers themselves, you know; we taught them all we knew about management in the 1950s and then were surprised when they proved to be such apt pupils! (Isn't it interesting that some of our current executives, who thought they had all the answers and didn't need their employees' contributions, are having to swallow their pride and learn from Japan a thing or two about human resources?)

"We seem to have lost sight of the emphasis on detail that can make both corporations and nations great."

In talking about the importance of concentrating on details, there is no better illustration than the area of human resources. A critical initial step is to acknowledge that employees are in fact a company's most valuable asset, whether it proclaims that in an annual report or not. Employers need to be rigorous in their recruiting to assure that they employ only the best people—and to remember in the process that attitude certainly is as important as skill. Skills, after all, can be learned; an attitude may persist for a lifetime.

Managers also should devote energy to educating people before they ever begin work so they'll know precisely what they must do, why it is important, and the standards they must meet. That is part of the process of buying employees' minds as well as their bodies, assuring that they can play a role in finding corporate solutions. Management needs to follow up by training the new workers on the job and cultivating their contributions to productivity. It needs to focus on cross-training and job sharing to impart multiple skills and develop versatile employees. In Japan, such on-the-job training time averages considerably longer than in the U. S.

Success also involves establishing trust, rather than an adversarial relationship, between workers and management. It means a management that encourages workers to experiment in search of new answers, even if they sometimes fail—as pathfinders inevitably fail, on occasion, in breaking new ground. And it demands an emphasis on management selection and promotion, elevating and rewarding the corporate heroes and not the palace politicians.

The burden, of course, isn't all on management. The employee must know that he or she can expect to be paid only if he produces something that someone —the all-important consumer— wants. There is no right of a job, just as there is no right of survival for a company that fails. The job, like the company's survival, is contingent on the value of its contribution, its sensitivity to the market. Inherent in that comment is the truism that companies can't afford nonproducers. A small but competent staff can achieve more than a fat staff loaded down with deadwood.

If workers and managements work together more closely, we can go a long way toward eliminating the polarization that has handicapped our companies for too long. So often we seem to be engaged in a self-destructive economic civil war. Again, perhaps we need to look to the Japanese model. The Japanese have achieved an impressive degree of cooperation between management, labor and government as well. Those three sectors surely have their differences, but they are responsible enough to team up when confronted by an external competitor.

Perhaps we should question just how much this difference in attitudes is influenced by our far greater reliance on attorneys when it comes time to negotiate labor issues. Personnel questions, after all, are sensitive matters that cry out for a spirit of teamwork, not confrontation. Maybe we, like the Japanese, can learn that our competition around the globe is too challenging for us to squander our energies on destructive infighting.

A Critical Oversight

In the continuing dialogue over our nation's macro issues we seem to have lost sight of the emphasis on detail that can make both corporations and nations great. This is an oversight that could prove fatal for a company, or even for a nation. Once we begin focusing on the micro solutions, we will begin impacting such issues as culture and ethics and behavior as well.

How can we accomplish the micro solution and restore our national competitiveness? For one thing, of course, we need to integrate the information from a multitude of disciplines and bring it to bear on our problems. We must, certainly, direct our attention to the sensitive area of human resources—learning again to treat our employees as professionals whose enthusiasm for doing their jobs well and for helping management find solutions can make or break a company. A giant step toward that increased respect would be a renewed emphasis on education at all levels. In the U.S., literacy may actually be declining. Along with that commitment to education, we must restore trust between management and labor as a crucial step toward restoring pride to the assembly line. Hopefully, that in turn can contribute to the rebirth of an American tradition of product quality recognized worldwide.

It seems clear that we can't expect to see the answers to our national dilemma come from Washington, whether from legislators or macroeconomists. The battles we are fighting today to regain our national stature won't be won by sweeping omnibus policies. They must be won daily on the shop floor through a concern for the consumer and through a national resolve to produce superior products. Perhaps we are already coming to recognize what needs to be done.

But the fight is an ongoing one, which starts with each of us. Attention to detail is inherent in successful corporate cultures. Success in the global economic warfare that we are engaging in now will demand the resolve of every one of the 100 million working Americans. That resolve begins with a commitment to detail; it results in excellence.

—Donald L. Koch

This article is based on a speech delivered in July to members of the National Association of Business Economists in Denver.