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The Slack Is Gone: How the United States Lost Its Competitive Edge in the World Economy

By Ian I. Mitroff and Susan A. Mohrman
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Immediately after the Second World War the United States enjoyed a crushing economic advantage because its productive machinery was more modern than anyone else's (and had not been bombed). But by the early 1970s, the forces that would eventually destroy South Chicago were being set in motion around the world. As investment capital became more mobile, companies were freer to shop for locations with lower wages and better "business climates," whether in Tennessee or Taiwan. The oil-price increases engineered by OPEC in 1973, and the resulting inflation, reduced the standard of living for most Americans—but not for workers in the heavy industries, whose unions had negotiated the cost-of-living adjustments known as COLAs. This was a temporary advantage for them and a long term disaster for their industries. During the late 1970s, when chronic inflation eroded the dollar's value in international trade, American goods became artificially attractive to foreign buyers—and American manufacturers were lulled into an artificial sense of security about their ability to compete. They were not prepared to adapt when circumstances changed in the early 1980s and an overvalued dollar drove their foreign customers away.[1]

It is by now no secret that, in recent years, the economic performance of the United States has declined, especially when compared with that of other nations such as Japan. On the other hand, little careful analysis has been done on why this has occurred. Such an analysis is more critical than ever, but before we as a nation can determine how to regain our competitive edge, it is first necessary to understand the factors that shaped the old way of doing business and why the old paradigm no longer applies. Only then can we look clearly at the new rules and new organizing assumptions that are essential to success in today's environment.

In the pages that follow, we will consider the factors that are responsible for the recent economic difficulties of the United States: the evolutionary path of the modern U.S. corporation and the kinds of consumer markets it created to complement its organizational structure; the special kinds of labor-management agreements that evolved as a result; and the role the government assumed in managing the U.S. economy.

In addition, the predominant position that until recently the U.S. had commanded in world markets contributed to its failure and, paradoxically, as a result of enormous successes, *not* failures, in managing the domestic economy, this nation was that much more vulnerable to the various world crises of the mid-1960s and 1970s. Finally, the refusal of Third World countries to play along with the "rules of the game" according to conventional economic theory added to our economic problems. To put it succinctly, the hardships we are currently experiencing are directly traceable to a failure to understand the critical role played by every one of these factors.[2]

The "Evolutionary" Path of the Modern Corporation

The history of man is the story of repeated attempts to wrestle order from chaos. The task of creating order is often difficult and painful, and it almost seems as if nature rewards our labor by causing us, first, to forget the initial pain involved in the act of giving birth to order and, second, leading us to believe that we have discovered the only solution to the problem of chaos, and for all time.

Thus, until relatively recently, we deluded ourselves as a nation into believing that we had solved the problems of economic organization. We forgot, because we had never really learned it, that the huge U.S. corporations that were created between 1870 and 1930 were only *one* solution at best to the problems of how to organize a society for the effective creation and distribution of wealth. At the same time, we also forgot that the modern corporation evolved only half consciously through a nonlinear process of experimentation, which used a lot of trial and error. The corporation certainly did not emerge flown blown as the result of any overall, grand design.

However, the modern U. S. corporation was consciously organized with the primary purpose of creating large standardized markets to which it could then supply the goods it created in large amounts. It was necessary to create such markets to justify and attempt to make secure the enormous capital investments required to produce large amounts of these goods. In other words, it was necessary to create simultaneously the large *external* markets that were necessary to absorb the large amounts of standardized goods that were *internally* produced by those large factories. Once the United States made the "decision" to abandon the innumerable small businesses that were the hallmark of

the 19th century and support the production and consumption of standardized products, then organizations capable of mass production and markets capable of mass consumption had to be created. Neither arises naturally in the social life of man. Both are social inventions and, as such, are social artifacts.

Thirty years ago, the life cycle of a product (say a refrigerator) from introduction (birth) to saturation (death) in the entire market was about 40 years. Partly this was so because it took longer than it does today for a new product to be adopted by the opinion leaders in society and to be disseminated to the masses. In addition, the initial high cost of new products was also a contributing factor in their diffusion to the general public. Today, mass marketing, relative low cost of new items, and mass communication have shrunk the time between the introduction of products and the saturation of mass markets to virtually zero. Unfortunately, instant market saturation has created all kinds of problems for manufacturers, in that it makes it harder for them to decide what to produce, for whom, for how long, and at what cost. How does one know that the market for a particular product or products will hold when the market demand may shift before a product is actually finished? The Japanese successfully dealt with this problem by constructing an industrial structure that could shift gears very quickly in response to changing consumer demands.

Complicating the problem of shifting markets is the fact that the United States and world markets are even less homogeneous than they were some 20 and 30 years ago. One of the reasons why mass consumption markets succeeded so well for so long in the United States was that, compared with other cultures (for example, European cultures), tastes were much more homogeneous from the very beginning. Furthermore, since the U.S. market was itself so big, American manufacturers could virtually ignore the rest of the world and concentrate on business at home.

All of these factors and others contributed to the attitude that we were invincible, and that we were anointed by history to occupy a privileged place in the pantheon of economic nations. We took the constancy and certainty of our economic environment for granted. *We could, in effect, "plan" for what people wanted and would consume without "planning" in the traditional sense, that is, using centralized state planning.* In effect, we had created a system in which centralized planning in the *overt* sense was unnecessary, because planning was *covertly* built into the design structure of our principal economic institution—the modern corporation.

The Role of Government and Organized Labor

Of course, the control that the modern corporation achieved over its environment was neither perfect nor complete. Indeed, the Great Depression demonstrated that this monolith was at best a partial solution to American economic problems: Since all markets, or the market as a whole, were ultimately dependent on the prosperity of the entire national economy, complete control over them was ultimately beyond the power of corporations.

For this and other reasons, government increasingly came to be viewed as having a critical, active role to play in managing (stabilizing) the economy. By not insisting on balancing the federal budget every year and by stimulating the economy through programs that benefited interest groups, the Federal government ameliorated the effects of severe ups and downs in economic cycles by pumping money directly into the economy. In this way, the government sought to ensure greater constancy of economic behavior, supposedly for the good of all. For instance, the U.S. government financed 90% of the national highway system; this backing not only directly stimulated the automobile and the construction industries, but also in effect gave them preference over other industries. Certainly, this was a national industrial policy of the highest order. Therefore, to say that we don't need industrial policies today when the environment is so much more turbulent than it used to be is to ignore the fact that we've always had such policies in one form or another.

While the government and large corporations in no way have even approached either perfect or complete harmony, they have moved steadily toward more accord in working together. Organized labor has at the same time also worked to ensure constancy in employment and wages. Since large corporations had a big stake in maintaining the mass consumption they worked so hard to create, they wanted to maintain the constancy of labor's purchasing power, even if they couldn't always admit this publicly.

The more that our economy moved toward mass consumption and mass production, the more sensitive it became to the ups and downs of consumers' purchasing power. Therefore, it was important for both labor and management eventually to reach wage-setting agreements that would stabilize income for labor, as well as the costs of production for management. The granddaddy of all these agreements may well have been the 1948 accords in the automobile industry between the United Auto Workers and General Motors, which tied wage increases to productivity and to changes in the consumer price index.

Overdependency on Slack

As helpful as these agreements were in forestalling unpredictable and rapid increases in labor costs and hence in the eventual cost of goods, which would be passed on to consumers, they also had some powerful, unforeseen, and unintended side effects. While various wage-setting formulas helped stabilize the economy (and benefited both labor and management), wage uniformity blocked the natural shift of resources that

occurs when wages fluctuate in response to supply and demand. That is, wage fluctuations send signals to corporate and governmental decision makers about where resources need to be allocated in order to redirect the economy.

Since wages in all industries increasingly became more and more uniform, attempts to get around wage setting by recruiting workers from one region (or one industry) to work in another ultimately failed. The only way to get around such formulas was to make use of what "slack" still remained in the economy—for example, to utilize the large pool of nonunionized, semiskilled workers in the South. The unintended effect of this strategy, however, was that the economy became increasingly dependent on such slack to maintain the versatility that is always required to maneuver around tight constraints. But the problem today is that this slack has been virtually used up. As a result, we have had nothing left to draw on to give us the edge in competing in world markets. Because of the enormous gains that organized labor made, U.S. workers became priced out of world competition.

Needless to say, the U.S. labor movement is not entirely to blame for the current state of affairs. Rather, it is important to remember that any large, complex economic structure demands from decision makers a great deal of foresight and sensitivity to economic forces. One wishes in retrospect that we could have designed better wage setting mechanisms that would have improved the lot of workers everywhere while preserving the power of wages to signal when and where changes needed to be made in the economy.

Both labor and management are equally to blame for what actually did happen. In an article on the automobile industry, *Business Week* noted:

> *Accustomed to prosperity without competition, both sides let efficiency and quality decline. Executives at GM and Ford admit that management is to blame for at least 80% of the industry's problems, including botched product designs, poor capacity utilization, and bloated staffs. . . .*
>
> *During the 1970s, productivity gains were eaten up by soaring wages and benefits that pushed the labor content of an average car to $2,300. Many analysts expect productivity among U.S. auto companies to improve by an annual average of only 5% over the next three years. This compares with 10% average yearly productivity gains in Japan, where labor rates are increasing only 5% annually. One result: Japanese cars now claim 17% of the U.S. market, despite voluntary restraints . . . . Once the quotas are dropped, some analysts say that Japan could snare some 35% of the U.S. market by 1987.*[3]

Both intentionally and unintentionally, the U.S. economy came to depend on slack in countless ways. For instance, because of its dominant position in the world economy, the United States took on a somewhat colonial role with regard to underdeveloped nations both before and after World War II. Raw materials of underdeveloped countries were available almost on demand to U.S. markets and at the best prevailing world prices. These raw materials thus served as reserves for the U.S. economy, much as the unskilled labor reserves of the South had earlier.

Further, by virtue of its dominance, the United States could run up long-term Federal deficits without having to devalue its currency. All of these actions allowed this nation to quell potential destabilizers of its economy. The cumulative effect was to addict the U.S. economy to artificial props so that when these props collapsed—as all props eventually must—the effect was to send the economy reeling, since its "fix" has been abruptly withdrawn. The economy had lost its ability to cope without artifacts.

The forces acting to reduce the slack the U.S. economy had relied on reached a critical mass in the mid 1960s and early 1970s. The world was rocked by a number of crises that were to change irreversibly the global economy. Here at home, the United States experienced a number of social movements that created permanent change in its social structure as well as its economy. For example, the civil rights movement, the women's movement, and the social protests against the war in Vietnam not only changed the social expectations of women and minorities; such upheavals also produced basic changes in the attitudes of U.S. workers so that wage setting was no longer governed by the written and unwritten social contracts of the past.

Furthermore, the United States was finally forced to abandon the gold standard, and thus could no longer run up huge deficits without devaluing the dollar relative to foreign currencies. This meant that the price of U.S. goods as well as the value of the U.S. dollar were increasingly subject to "distant" economic forces that were no longer directly connected with the performance of the U.S. economy—nor under its control. International economic forces, together with the saturation of internal U.S. markets for traditional consumer goods and the breakdown of demand for standardized goods, produced a devastating effect on our mass production economy.

The Emergence of the World Economy

While the U.S. economy was increasingly being affected by distant foreign economies, the world economy was becoming more and more interdependent. As

Business Week put it: " . . .Europe's [economic] fate still depends critically on what happens across the Atlantic. The vaunted decoupling of Europe from the U.S. is still a long way off."[4] We would add: The decoupling of *any* economy from the United States is an "infinite" way off.

As if these paradigm shifts weren't enough, two oil crises occurring in the 1970s wreaked havoc on the Western economies. Since the West is dependent on the availability of cheap energy, the sharp, dramatic increases in oil prices created tremendous inflation in that part of the world. Of course, the prices of virtually all goods rose and put pressure on all wages to rise as well. Finally, the whole world was thrown into an economic downturn because of the rippling effects of unprecedentedly high U.S. interest rates.

The worst, at least from the standpoint of the United States, was not over yet. The final blows were delivered by the Third World countries and Japan. By the end of the 1960s, both had begun to change the rules of the international economic game. According to conventional economic theory, Third World countries were supposed to export to the developed countries cheap, raw materials, which would then be transformed into finished products and sold back to them at a higher price—thus insuring a balance of payments in favor of the United States. But the Third World learned a different economic game. They began to use their cheap labor to produce the goods themselves. They trained their laborers to perform high quality, technical work and created new financial and market institutions to favor their goods. For example, they rewrote their tax codes to favor certain industries and even encouraged their banks to offer cheap loans to those favored industries.

All the time, Japan was learning how to structure industry based on a different mix of principles. They were learning how to combine the advantages of both mass production and specialized craft industries. The Japanese created an industrial structure based from top to bottom on flexibility. It was craft oriented in the sense that it was geared to producing high quality, specialized goods, but it was oriented toward mass production in that it was geared to producing these goods in great numbers. The Japanese model was based on flexibility in that it could shift very quickly when it was no longer profitable to produce a particular product.

In response to these new, competitive threats, U.S. companies tried various competitive strategies, none of which worked for very long. First, companies diversified. They merged with and acquired one another with great speed. They engaged in paper entrepreneurship at record levels—that is, account manipulation—to create profits on paper, but not in actual reinvested capital, which is what actually creates future productive capacity. But these tactics didn't work because the addition of unstable businesses to those already threatened only made the economic climate more precarious. U.S. businesses also tried to produce "world products" such as Ford's "world car," the Escort. But this strategy no longer worked as well, since international markets were now organized around increasingly differentiated tastes. To sell well, one had to sell products that were directly targeted to the needs of consumers in local markets. Again, the United States needed flexibility to produce the kinds of products that would match the needs of local markets around the world.

Short Term Myopia

Other events were also occurring that hampered even further the ability of American business to compete effectively in the new world economy. By 1984, *Business Week* could report that

> *"Figures compiled by the Labor Dept. show that pension plans governed by ERISA (Employee Retirement Income Security Act) regulations control some $1 trillion in capital, concentrated predominantly in corporate stocks and bonds. On average, institutions account for 80% to 90% of all daily trades."*[5]

This statement shows that the people who manage and control ERISA's plans have an extremely short term perspective of the U.S. economy. Their concern with immediate profits (this quarter) puts enormous pressures on executives and shareholders to attend only to the present and to discount the future almost entirely. To do so means sacrificing long term ventures; innovative products that cannot, by definition, always show an immediate profit; and marginally profitable businesses that show indications of becoming profitable in the future.

Executives are not necessarily happy with this state of affairs. In the same *Business Week* article, a number of top executives reported their intense dissatisfaction. For instance, Greg A. Smith, executive vice-president of Prudential-Bache Securities, observed that "The typical investment cycle was three to five years in the 1960s. Now . . .it's more like a casino operation." And Edward D. Zinbarg, senior managing director of Prudential Equity, noted that "The short-term emphasis ultimately hurts the whole economy, [but] I don't know what you can do about it."

Finally, Leon G. Cooperman, partner of Goldman, Sachs, one of the biggest investment firms in the United States, said: "I don't think any company can afford a long-term investment today unless its managers own 51% of it." U. S. companies are being encouraged to play it extremely safe exactly at the time when this is precisely what they cannot afford to do.

Three Lessons that Need to Be Learned

Again and again, on this very front, the United States is still struggling to learn the same three lessons. First, it had used up all its strategic reserves, or slack. The only slack still remaining is the boundless energy, creativity, and self-confidence of the American people, if only we could harness those resources to our advantage once again. Second, the age of unrefined mass production and mass consumption is over. This is the age of highly refined, specialized, niche markets, paradoxically mass niche markets. Third, every strategy that created success in times of stability and plenty now produces failure in these times of severe worldwide competition.

None of this is really surprising. One rule that history teaches is that when faced with crisis the vast majority of people and institutions repeat the mistakes that got them into trouble in the first place. They intensify those strategies that worked well under very special conditions with the hope that they have found the magic solution for all time.[6]

As Emerson knew, a foolish or simpleminded consistency is "the hobgoblin of little minds, adored by little statesmen and philosophers and divines." It is sometimes better to change direction abruptly and to lose one's face than to lose one's entire life. It takes an act of heroism to admit that one's course of action is leading to disaster and to change one's behavior. U.S. businesses began to be the cause of their own undoing and, sadly, did not even realize the fact. They did this by:

- Believing that there is "one best way" to approach all problems or that for each problem there is only "one best answer";
- Sticking to and enforcing rigid cost and management formulas, narrow programs, tired products, and inflexible production quotas long after they have ceased to serve their original intended purpose;
- Attending to only immediate short term problems and issues, focusing on details, seeing only the parts and not the whole, ignoring the long term, failing to put problems in a context, and losing sight of the overall objectives of the organization and the entire economy;
- Judging the performance of something as complex as an entire organization in terms of single and simpleminded standards such as "the bottom line" and thus ignoring the multitude of all the other competing standards to which the modern organization is now subject, for example, the health and general welfare of its customers, employées, and the surrounding community and environment in which an organization does business and on which it depends to do business; and
- Failing to be aware of the implicit and unstated assumptions that have guided individual behavior and organizational policies in the past and failing to change them when they were no longer appropriate in the current environment.[7]

Why Faddism Is not the Answer

It is not surprising that in this environment U.S. businesses easily fell prey to every new management fad promising a painless solution, especially when it was presented in a neat, bright package. But all simple formulas are eventually bound to fail. By definition, simple formulas cannot cope with complexity, and complexity is what today's world is all about.

Thus, the November 5, 1984 issue of *Business Week* documented the problems in some of the "excellent" companies first identified in Thomas J. Peters and Robert H. Waterman's *In Search of Excellence.* Peters and Waterman identified eight key attributes of excellence: (1) having a bias toward taking action; (2) staying close to one's customers; (3) giving autonomy to individuals and individual operating units; (4) securing productivity through empowering people; (5) using a hands-on, value-driven approach to management; (6) sticking to one's knitting; (7) using a simple form and lean staffing; and (8) creating a simultaneously lose-tight management structure.[8]

As Peters and Waterman freely acknowledge, they never intended that these attributes be used as a simple formula for success. Indeed, by *sticking close* to one's customers one gets *stuck* to them and can't extricate onself when the market shifts dramatically out from under one's products. Or suppose a company gets *ensnared* in its knitting by *sticking* too close to it for too long; for example, it continues to produce excellent products, but the market shifts so that it can find itself making first-rate buggy whips.

Neither did Peters and Waterman intend their book to be a magic formula for success. However, it's unfortunate that they did not tell managers that their eight attributes ought to be used as a guide and not be followed blindly. Indeed, we've been inside some of the very companies that Peters and Waterman discuss and have come to a very different assessment. We suspect that our converging viewpoints may be because, unlike Peters and Waterman, we talked systematically to people at all levels of those organizations.[9] Not everyone is systematically practicing Peters and Waterman's eight strategies. Indeed, different parts of many of the so-called excellent companies are at cross-purposes. We suspect Peters and Waterman arrived at these conclusions by talking very selectively to certain levels of organizations.

In the end, the failure of *In Search of Excellence* is not that its message is all wrong, but that, like all quick-fix guides, the books lacks a method for helping managers debate, and thereby assess, the proposed attributes of excellence. We must finally learn that complex problems will not be solved with simple formulas, no matter how appealing they are. This is the lesson of

our brief review of how American business got into its current predicament. We have deliberately reported the bad news because there is no sense in ignoring it.

Fortunately, there is also good news. Many of our largest organizations and industries have been "at death's door" and, as a result, have learned that they can't do "business as usual" and that they have to change. They are learning to recreate themselves so that they can compete effectively in a world economy that is governed by an entirely new set of rules. ◘

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Dr. Mohrman has published papers on the topics of the quality of work life, innovative approaches to the design of organizations, organizational development processes, high technology organizations, union-management cooperative processes, and innovative research and evaluation methodologies. She is an editor of Research for Theory and Practice *(Jossey-Bass, 1985), and has been active in the Academy of Management, including being a member of the AME Editorial Review Board as well as in various labor/management and management education groups.*

ENDNOTES

1. This quote is taken from James Fallows's article, "America's Changing Economic Landscape," *The Atlantic*, March 1985, page 56.

2. The analysis offered in this paper is based primarily on the works of the following authors: Russell L. Ackoff's *Creating the Corporate Future: Plan or Be Planned For*, New York: John Wiley, 1981; James C. Abegglen and George Stalk, Jr.'s *Kaisha, the Japanese Corporation*, New York: Basic Books, 1985; Ralph H. Kilmann's *Beyond the Quick-Fix: Managing Five Tracks to Organizational Success*, San Francisco: Jossey-Bass, 1984; Ian I. Mitroff and Ralph H. Kilmann's *Corporate Tragedies: Product Tampering, Sabotage, and Other Catastrophes*, New York: Praeger, 1984; Michael J. Priore and Charles F. Sabel's *The Second Industrial Divide*, New York: Basic Books, 1984; Charles Reich's *The Next American Frontier*, New York: Time Books, 1983; and Bruce R. Scott and George C. Lodge's (eds.) *U.S. Competitiveness in the World Economy*, Boston: Harvard Business School Press, 1985.

3. See Charles Reich's "Showdown in Detroit: The Future of the Industry—and the UAW—Is at Stake in the Auto Talks," *Business Week*, September 10, 1984, pages 104-105.

4. See Michael J. Priore and Charles F. Sabel's "The World Can't Shrug Off a U.S. Showdown for Long," *Business Week*, December 10, 1984, page 51.

5. See James C. Abegglen and George Stalk, Jr.'s "Will Money Managers Wreck the Economy?: Their Short-Term View Derails Companies' Long-Term Plans," *Business Week*, August 13, 1984, page 88.

6. See Ian I. Mitroff and Ralph H. Kilmann's *Corporate Tragedies: Product Tampering, Sabotage, and Other Catastrophes*, New York: Praeger, 1984.

7. See Richard O. Mason and Ian I. Mitroff's *Challenging Strategic Planning Assumptions*, New York: John Wiley, 1981.

8. See Thomas J. Peters and Robert H. Waterman's *In Search of Excellence: Lessons from American's Best-Run Companies*, New York: Harper & Row, 1982.

9. See Ian I. Mitroff, Susan A. Mohrman, and Geoffrey Little's *The Global Solution: The New Rules for Doing Business in a World Economy*, San Francisco: Jossey-Bass, 1987.