

Washington University in St. Louis

Washington University Open Scholarship

Murray Weidenbaum Publications

Weidenbaum Center on the Economy,
Government, and Public Policy

Contemporary Issues Series 37

3-1-1990

The Myth of the Hollowed-Out Corporation

Murray L. Weidenbaum

Washington University in St Louis

Follow this and additional works at: https://openscholarship.wustl.edu/mlw_papers



Part of the [Economics Commons](#), and the [Public Policy Commons](#)

Recommended Citation

Weidenbaum, Murray L., "The Myth of the Hollowed-Out Corporation", Contemporary Issues Series 37, 1990, doi:10.7936/K75T3HNX.

Murray Weidenbaum Publications, https://openscholarship.wustl.edu/mlw_papers/19.

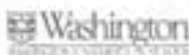
Weidenbaum Center on the Economy, Government, and Public Policy – Washington University in St. Louis
Campus Box 1027, St. Louis, MO 63130.

Other titles available in this series:

24. *Crowding Out Small Business: The Unfair Competition of Nonprofits*, Thomas DiLorenzo
25. *The Benefits of Deregulation*, Murray Weidenbaum
26. *Lessons From Abroad: Japanese Labor Relations and the U.S. Automobile Industry*, Thomas DiLorenzo
27. *Competition Deserves More Than Lip Service*, Daniel Oliver
28. *Economics and the National Security*, Murray Weidenbaum
30. *America's Rendezvous with Reality*, Murray Weidenbaum
31. *Antitrust Policy and Competitiveness*, Thomas DiLorenzo
32. *The Market for Corporate Control: Political vs. Managerial Agents*, Dwight Lee
33. *The Legal Revolution in Product Liability*, Peter Huber
34. *The Global Marketplace and Government Policy*, Murray Weidenbaum
35. *Public Compassion and Political Competition*, Dwight Lee
36. *The Changing Economic Role of Defense*, Murray Weidenbaum

Additional copies are available from:

Center for the Study of American Business
Washington University
Campus Box 1208
One Brookings Drive
St. Louis, Missouri 63130-4899
Phone: (314) 889-5630



The Myth of the Hollowed-Out Corporation

by Murray Weidenbaum

*Contemporary
Issues Series 37*



Center for the
Study of
American Business
Washington University • St. Louis

The Myth of the Hollowed-Out Corporation

by Murray Weidenbaum

The current status of the manufacturing sector of American business furnishes a cogent example of the recognition lag in economic life.

From a cyclical peak of 113.4 in July 1981, the industrial production index declined approximately 13 percent to a low of 100.5 in October 1982, or just about back to the level of 1977, which is the base year for the index. Individual sectors of manufacturing, especially primary metals, dropped even more precipitously.

During this period, a cottage industry developed (appropriately in the service sector) based on the simplest relationship known to quantitative analysts: Two points determine a straight line. By connecting the number for 1981 (for almost any series except unemployment) to the corresponding number for 1982, analysts observed a downward sloping trend line. A brigade of doom-and-gloom forecasters began bemoaning the demise of American manufacturing and the stagnation of the economy generally.

The year 1982 produced a bonanza of negative reports. Ira Magaziner and Robert Reich wrote, "The U.S. economy is in crisis. . . . In the absence of new strategic directions, the crisis can only deepen."¹ Lester Thurow reported, "The engines of economic growth

Murray Weidenbaum is Director of the Center for the Study of American Business and Mallinckrodt Distinguished University Professor at Washington University in St. Louis. This study is adapted from an article appearing in the January 1990 issue of *Business Economics*, the journal of the National Association of Business Economists.

have shut down and they are likely to stay that way for years to come² And, of course, 1982 was the year that saw John Naisbitt's *Megatrends* proclaim that the industrial era was over and that we were rapidly becoming a microeconomic information self-help society characterized by a galaxy of networking constellations.³

Given its special recognition lag, it took *Business Week* until March 1986 to conclude that the American industrial enterprise was becoming "hollow," relegated to the marketing of products made in other nations.⁴

But the linear economic forecasters were caught off guard by an off-their-chart development that began in 1982. Late that year saw the beginning of the longest peacetime expansion in American history. By September 1983, the previous peak in U.S. industrial production was passed. The best was yet to come. By the end of 1988, the rate of industrial production was 40 percent above the previous cyclical low and 24 percent over the previous cyclical high. The manufacturing sector today contributes just about the same proportion of the total output of the American economy as it did three decades ago. But the notion of a negative sloping trend line, especially in manufacturing, was too deeply imbedded to be displaced in prevailing public thinking.

Moreover, the good news often was reported as bad news. That is, rising productivity enabled the industrial economy to produce more with less, less labor that is. But to those who ascribe to the quaint notion that the health of a sector should be measured by its inputs rather than its outputs, the results were considered devastating. After all, manufacturing employment in the United States has never recovered to its peak of slightly over 21 million achieved in 1979.

Those who bemoan the shift in the U.S. economy from manufacturing to services tend to imply that this is a recent development. Despite the attention placed on this

shift since 1982, an inspection of the Census Bureau's *Historical Statistics* reveals that the crossover from manufacturing to the service sector as employment leader occurred in the nineteenth century. By 1900, service employment exceeded manufacturing employment by a ratio of eight to five.⁵ That recognition lag again!

*By 1900, service employment
exceeded manufacturing employment
by a ratio of eight to five.*

Most realistic appraisals of the future conclude that the total number of jobs in manufacturing is not likely to grow much, if at all, in the coming decade. But their complexity -- and pay -- will continue to rise. Flexible automated systems are restructuring production technology and helping to keep American firms competitive in world markets.

A decade from now, most viable U.S. manufacturing operations will be more fully automated than they are today. They generally will have converted to flexible systems that can be continually reprogrammed to make a large variety of products, attaining economies of scope, while maintaining necessary economies of scale.

Any doubt on that score could be dispelled by just listening to the executives in the European Community who fear post-1992 competition from larger and stronger and higher-tech American enterprises. The United States continues to possess the basic capabilities necessary to maintain leadership in many industrial areas. No other nation devotes as much to basic research year in, year out. R & D performed in the United States each year exceeds the combined totals of Japan, West Germany, France, the United Kingdom, and Sweden.⁶

No other country possesses comparable capability in computers and software. No other economy has the depth, breadth, or scope of technical-industrial infrastructure that can translate basic discoveries into useful products and processes in a relatively short time.

Moreover, the United States is still the world's largest market with a common language and a strong entrepreneurial culture. The domestic availability of capital resources to finance new investment -- and not just in LBOs and hostile takeovers -- is awesome.

While the wailing goes on about the supposed erosion of our manufacturing base, three key forces are at work which make for a strong industrial sector of the American economy in the years ahead:

1. Numerous company actions are reducing the cost of producing goods and services in the United States.
2. American workers and managers are showing a new awareness of their personal responsibility for the quality of what they produce.
3. Private investment in R & D, the basic fuel for innovation and technical progress, is continuing to grow.⁷

Let us examine the increased importance of each of these factors.

Reducing the Cost of Production

For a variety of compelling reasons -- most notably, to keep up with foreign competition and to fend off potential takeover threats -- a great many American business firms have been reducing their costs of production. Nearly every sector of manufacturing -- automobiles, steel, chemicals, textiles, and machinery -- has been aggressively cutting costs. The specific responses they have made range from simple changes in production methods to a basic restructuring of the entire business. About half of the firms sur-

veyed by the American Management Association downsized their operations between January 1986 and June 1987. More have done so since.

For all of 1988, the number of work stoppages involving 1,000 employees or more totaled 43 -- compared to 300 a decade earlier.

Because the compensation of employees constitutes about two-thirds of the cost of producing the nation's output, labor costs are a natural for cutting. The measurable changes in the labor market are dramatic. Competitiveness has been enhanced by the substantial slowing of the rise in wage costs. In 1980, the average U.S. worker in the private sector received a 9 percent wage boost. By mid-1989, the average annual increase was half of that. In some industries, workers have "given back" prior wage and benefit increases.

We should not be confused about motivations. Reduced wage demands and givebacks do not arise because workers are suddenly worried about stockholders. Rather, their new attitude reflects tough on-the-job economic education or often out-of-job economic education. The new competitive reality has especially impacted workers in companies that, in the past, provided unusually generous increases in wages and fringe benefits.

Strike activity is at the lowest point since the Labor Department first started collecting the numbers. For all of 1988, the number of work stoppages involving 1,000 employees or more totaled 43 -- compared to 300 a decade earlier. Despite the growth in the labor force, the total of 121,400 workers idled by strikes in 1988 was a small fraction of the 1.4

million annual average in the 1970s.

Import penetration has sparked what often approaches a war on costs. Companies have often obtained union agreement for more flexible work rules -- a broadening of traditional narrow job classifications -- that generate important savings in the production process. With new agreements to perform several different tasks, fewer workers are required or the same number of workers can produce more. Also, downtime is reduced when it is no longer necessary to wait for a worker with the right classification to make a repair.

Many American companies have adopted the Japanese just-in-time (JIT) production and inventory system. In addition to freeing up inventory and storage space, JIT has forced many companies to do better sales forecasting and delivery planning.

An extension of the economizing strategy is leading to important structural changes in a great many of the larger American corporations. The horizontally integrated firm, producing virtually every product in the markets in which it operates, is becoming much less prevalent. Many companies -- notably in the chemical industry -- are finding it preferable to specialize, focusing on specific product niches that are more secure against foreign competition. This is to be expected as U.S. firms find themselves competing more fully in a global economy. Fewer domestic markets now can be thought of as part of a closed economy.

In addition, a rapid rate of product innovation has been emphasized by many U.S. firms, especially in industries that are hard hit by imports. American shoe companies have responded with stylish footwear to ward off foreign competition. Apparel manufacturing, one of the most import-affected industries, is relying heavily on style to compete with low-cost foreign products.

Clothing producers are maintaining profitability through improved timing and greater

flexibility of production. Foreign apparel makers typically need six months or more lead time to coordinate manufacturing with retail sales. Some domestic companies can produce products for store shelves in three to four weeks. That enables them to set a trend, with foreign producers lagging a season behind.

Improving Product Quality

Foreign inroads into U.S. domestic markets have frequently been caused by the superior quality of imports rather than just lower costs. As a result, unprecedented pressure has been generated for improving the quality of products that American businesses manufacture.

The payoff from higher quality is larger than generally perceived. It comes from the savings realized by doing the job right the first time, avoiding the costs of reworking and repairing defective products and, in the process, avoiding the alienation of customers.

At some manufacturing companies, employees receive as much as forty hours of training to enable them to measure the quality of their output, a move that often has resulted in a rise in defect-free products coming off assembly lines.

The enhanced concern with improving quality in American industry has not been primarily a matter of setting up new quality control departments or even expanding existing ones. Companies in the United States have traditionally devoted more resources to quality-control efforts than their foreign counterparts.

Quality assurance means more than just a collection of expensive professional personnel who check, review, and improve production practices. The most effective quality controls involve a shift in the locus of responsibility -- from the inspectors in the quality control department to the people who actually do the work.

The Growth of Industrial R & D

It has become commonplace to state that American business thinks short-term and that this unfortunate tendency shows up in decreasing outlays for research and development. Commonplace, yes. True, no. A little historical and statistical perspective can be a real eye opener.

As we know, the 1980s witnessed a substantial growth in the R & D financed by the federal government, mainly for defense purposes. This was a significant departure from the trend of the 1970s, where federal government spending for R & D, in real terms, was stagnant. According to the traditional wisdom, civilian R & D in the 1980s should have declined as scientific and technological resources were being hogged by the military.

*For the decade 1980-89,
private industry outspent the
federal government on R & D,
\$445 billion to \$430 billion.*

Actually, something very different occurred in the private sector in the 1980s, simultaneous with the rapid defense buildup. For the first time since the National Science Foundation began gathering the data, business outlays for R & D exceeded government R & D spending. For the decade 1980-89, private industry outspent the federal government on R & D, \$445 billion to \$430 billion (in constant 1982 dollars).⁸ In eight of those ten years, the private sector has been a larger source of financing for R & D than the public sector. The number of scientists and engineers in American industry doing R & D rose from 469,000 in 1980 to 595,000 in 1987.

Consider the implication of these numbers. In the United States, private business traditionally performs the bulk of R & D.

However, prior to 1980, most of the projects were sponsored by the federal government and business was responding to the public sector's priorities. But since 1980, most of the R & D work performed by American companies has also been financed and sponsored by them. Thus, the results are far more geared to commercial markets than in the past.

On this basis, I suggest that there is an excellent chance that, contrary to general expectations, we will see more product and process innovation in the United States in the years ahead. As Alfred Chandler, the distinguished business historian, reminds us, technology has been the prime mover behind the success of the modern corporation.⁹

The Three Factors Together

These three factors -- cost cutting, quality improvements, and expanded research and development -- rarely yield quick and dramatic changes. Yet, their cumulative effects are likely to endure and to reinforce each other. All three factors work in the same direction -- toward developing new or better or cheaper products.

These changes will not prevent imports from continuing to threaten individual companies. Influences external to the industrial economy often can be vital. Exchange rate fluctuations, as we have seen in recent years, can be of especial importance. But, over the longer run, these three basic forces make for a brighter industrial outlook for the United States as a whole.

Solid evidence is already available. The average manufacturing company in the United States has become more productive during the 1980s, in the conventional terms of how much is produced per labor hour. From 1973 to 1981, domestic manufacturing firms averaged a subnormal increase in productivity of 1.5 percent yearly. From 1981 to 1988, the average rate of productivity growth

more than doubled, to 3.8 percent a year (that is also comfortably higher than the average rise of 2.7 percent a year during the period 1948-1973).

Thus, there is a reasonable basis for believing that American firms will be more effective competitors in world markets in the years ahead. Likewise, the relative attractiveness of domestically produced products to American consumers is being enhanced.

A word of warning is in order: these positive developments in American industry do not guarantee success in the future. Overseas competitors will not run in place while U.S. companies try to catch up or keep ahead.

And new international competitors are vying for global markets. It is intriguing to note that South Korean construction companies, which have increasingly been giving their American counterparts tough competition in bidding on overseas projects, are now complaining about the even-lower-cost rivalry from Turkish and Indian firms.

The Public Policy Outlook

The chances of a strengthened manufacturing sector in the 1990s will be influenced by changes in public policy. Efforts to reduce the budget deficit on the revenue side can result in further increases in the tax burden on saving and investment.

In contrast, action on the budget deficits via spending cuts would be constructive, especially if the cuts focus on consumption. It is worrisome that budget deficits have become a means for converting private saving into public consumption. A lower deficit should also reduce the pressure on real interest rates. That would reduce the high cost of capital in the United States, a key deterrent to competitiveness.

Should domestic protectionist pressures succeed in erecting additional trade barriers, much of the burden would be borne by the

industries using the higher-priced, protected products. Conversely, new trade barriers put in place by the European Community could inhibit U.S. exports.

Enhancing the competitiveness of American industry is not a question of how to get government to do more for manufacturing, but how to get it to do less to manufacturing.

A new round of burdensome domestic government regulation would both raise the cost of compliance and deter companies from investment and innovation. Further use of "social mandates" to finance federal social objectives off budget -- such as higher minimum wages, compulsory health insurance, required parental leave -- would increase the cost of doing business in the United States. On balance, the potential changes in public policy, at home and abroad, seem to be in large part negative in terms of their impact on the industrial economy.

Thus, enhancing the competitiveness of American industry is not fundamentally a question of how to get government to do more *for* manufacturing, but how to get it to do less *to* manufacturing. Regulation should be made more cost-effective and less onerous. The tendency for Congress to "do good" via social mandates should be curbed. Federal deficits should be reduced, but not by adding to the tax burdens on saving and investment.

There is one key aspect of public policy which is ripe for positive improvement -- education of the nation's work force. It is nothing short of a national disgrace that this country's literacy rate is lower than that of most countries with whom we compete and our school dropout rate is higher. An increasing number of unglamorous manufac-

turing industries in the United States report difficulty in attracting young new workers with even minimum math and reading skills.

But these difficulties should not lead us to the erroneous conclusion that we must spend more on education, although the marginal return on investment in education continues to be relatively attractive. The fact is that, each year since 1980, the people of the United States -- from federal, state, local, and private sources -- have been spending more on education, per pupil, than the year before, and in real terms. We also spend a larger share of our GNP on education than most other nations.

The real shortage in education is in ways of spending the money wisely. Take the chronic shortage of high school math and science teachers. For decades, the public school systems have refused to pay more for skills in short supply. If colleges and universities were to follow such an archaic "comparable worth" approach, every medical school in the country would be forced to close, as would most engineering schools.

Conclusion

Ultimately, however, the future of manufacturing will be determined by the business sector, by those business executives that make the tough product, market, and financial decisions that are at the heart of increasing productivity and maintaining competitiveness.

On the other hand, the specter of high-powered business executives running to Washington with hat in hand is not a particularly noble one. In this regard, there is an important role for the citizen/voter to support changes in government policies that make it less attractive to travel to Washington for help. A bailout is a bailout, even if it's for high-definition television. Say's law -- supply creates its own demand -- works with a vengeance in this area: the supply of aid to

"worthy" businesses encourages the demand for that aid.

Citizens offended by large corporate PAC contributions and generous honoraria to members of Congress should focus on the root cause -- the great amount of arbitrary power over business possessed by government officials. Reducing that power is the most effective way of curbing PACs and discouraging honoraria to the makers of government policy.

Those political contributions will not be forthcoming so readily if the money could be put to better use in more conventional business undertakings. The nation's welfare -- and its economic efficiency -- would indeed be better served by redirecting those resources into productive private investment.

The inevitability of American deindustrialization and the "hollowing out" of American business is just another example of modern mythology. On balance, the future prospects for American manufacturing are bright, far brighter than generally realized.

NOTES

1. Ira Magaziner and Robert Reich, *Minding America's Business* (New York: Vintage, 1982), p. 375.
2. Lester Thurow, "The Great Stagnation," *New York Times*, October 17, 1982, sec. 6, pp. 32, 36.
3. John Naisbitt, *Megatrends* (New York: Warner Books, 1982).
4. "The Hollow Corporation: The Decline of Manufacturing Threatens the Entire U.S. Economy," *Business Week*, March 3, 1986, pp. 57-85. Since March 1986, industrial production in the United States has risen 14 percent, faster than the long-term trend.
5. Bureau of the Census, *Historical Statistics of the United States*, pt. 1 (Washington, D.C.: Government Printing Office, 1975), p. 137.
6. D. Bruce Merrifield, "The Forces of Change Restructuring the U.S. and World Economies" (Presentation to Human Resources Services, Inc., New York City, October 22, 1986), pp. 8-9; Leonard L. Lederman, "Science and Technology Policies and Priorities: A Comparative Analysis," *Science*, September 4, 1987, p. 1127.
7. See Murray Weidenbaum, *Rendezvous with Reality: The American Economy After Reagan* (New York: Basic Books, 1988), Chapter 7.
8. U.S. National Science Foundation, *National Patterns of R & D Resources* (Washington, D.C.: NSF, 1989), Table B-5.
9. Alfred D. Chandler, Jr., *The Visible Hand: The Managerial Revolution in American Business* (Cambridge, Mass.: Harvard University Press, 1977).