Immaculate Planners or Messy Entrepreneurs?

BY BURTON FOLSOM, JR.

"We need help from government. We need to hire experts to pick winning companies, and then we can subsidize them to come and bring more jobs to our state." From time to time, for almost two centuries, that has been the battle cry from states across the nation. Most recently, Governor Jennifer Granholm of Michigan has unveiled a $2 billion Jobs Tomorrow proposal that will allegedly attract new industry to her rust-belt state.

Students of economic history will immediately ask: What is the government's track record for picking winners? The answer is that such experiments form a long train of disasters. As Henry Hazlitt once observed, "There is no more persistent and influential faith in the world today than the faith in government spending."

Since Michigan is where the latest government program is planned, let's use that state as a historical example. When Michigan first joined the union in 1837, its political leaders believed that their state's northern location was too remote. To induce industry, Governor Stevens T. Mason and the legislature sold $5 million in bonds to build the "high-tech" industries of the era—railroads and canals—to detour businesses and people northward to Michigan.

Sure enough, the bonds were sold and the "experts" surveyed routes for one major canal and two railroads. The canal cost $350,000, was poorly constructed, and earned $90.32 in tolls before it was abandoned. Then came the railroads, and the state ran out of money before completing either one. What's more, both tracks were so shoddily constructed that trains were barely safe moving back and forth on them.

At that point Michigan abandoned having politicians and experts pick winners and losers. The state sold the railroads to private investors, and in three years they had both railroads rebuilt, completed, and running smoothly across the state. Michigan voters celebrated this event by changing the state's constitution so that the state could "not subscribe to or be interested in the stock of any company, association, or corporation," or engage "in any work of internal improvement."

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Governor Granholm's proposal is similar in kind to the state's early railroad fiasco. She wants independent experts—from the American Association for the Advancement of Science (AAAS)—to target future winning investments for the state, and she even wants to amend the 1850 state constitution to allow the state to hold equity in some of these new businesses.

There are three reasons why Michigan's $2 billion subsidy, if enacted, would probably do more damage to the state's taxpayers than good to the state's economy. First, economic projects shaped by politicians and "experts" use other people's money, in contrast to projects shaped by entrepreneurs and investors, who use their own money. Politicians have every incentive today, as they did in the 1830s, to employ economic development mainly to gain votes—governors and state legislators win elections when they bring outside industries into their districts.

Second, the so-called "experts" often have hidden agendas. The experts at the AAAS, for example, believe in harmful global warming and avoid publishing any argument against it in their magazines. They have every

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incentive to promote ideas (for example, solar panels and battery-operated cars) that fit their conception of how the world should work, rather than how it actually works.

Third, even when experts put aside their personal agendas, they are notoriously poor at picking winners and losers. This bad record goes beyond the canals and railroads they picked for Michigan in the 1830s. They almost did it with the auto industry too: the experts of 100 years ago picked horses and carriages over cars. The president of the Michigan Savings Bank in 1903 refused to back Ford Motor Company because "the horse is here to stay, but the automobile is only a novelty—a fad." Six years later, after Ford scraped up the private capital to build his first Model T, the experts at *Scientific American* concluded that "the automobile has practically reached the limits of its development. . . ."

David Hollister, Governor Granholm's labor and economic growth director, has asked a fair question: If not Jobs Tomorrow, "What is your alternative?" The best answer is: Low taxes and strong property rights attract investors; high taxes repel them. Therefore, cut the tax rate, kick out the planners, and thereby attract the world's best entrepreneurs to your doorstep.

That conclusion—that reality, if you will—is hard to see. It requires faith in the invisible workings of markets rather than faith in the visible actions of planners and politicians. To help understand why such faith in markets is well placed, let's look at the specific historical example of the Coolidge tax cuts, which were applied nationwide in the 1920s.

When the American economy slowed down after World War I, Presidents Harding and Coolidge argued that high tax rates were at least partly responsible for the double-digit unemployment the country faced. During the 1920s both presidents began slashing the tax rates until the top rate had fallen from 73 to 25 percent and the bottom rate from 4 to 1.5 percent. America's wealthy entrepreneurs could now keep three-fourths of their income instead of giving three-fourths of it to the government. The improved investment climate helped lead to a sharp rise in business starts, patents, and corporate expansion, and a big drop in unemployment, which averaged only 3.3 percent during Coolidge's presidency.

Experts Defied

During the 1920s entrepreneurs defied the logic of experts. The radio, for example, became the most popular innovation of the decade. But Lord Kelvin, the president of the British Royal Society, had warned earlier, "Radio has no future." Then in 1922, when radios began to sell, Thomas Edison predicted, "The radio craze . . . will die out in time." Six years later, when radios were becoming standard household items, H. G. Wells, the futurist, pronounced the radio to be a mere fad: "[T]he truth is that I have anticipated its complete disappearance. . . . [T]he unfortunate people . . . listening in will soon find a better pastime for their leisure."

Air-conditioners and zippers, two other innovations of the 1920s, had to overcome similar objections from experts. In the case of the zipper, the patent office had no idea how to comprehend such an invention and knew not how to classify it. When Gideon Sundback, its major inventor, first put zippered money belts on the market, sales were low; no one yet had the vision for how such a product could be widely used. Finally, in 1923, B. F. Goodrich took a chance and sewed zippers onto 150,000 pairs of galoshes. Their sales boomed. Putting zippers later on clothes was an unexpected afterthought.

Willis Carrier, the inventor of the air-conditioner, was fired by the heating and cooling experts at the Buffalo Forge Company, even after he had shown them that his contraption worked. Carrier finally struck out on his own and hit pay dirt in 1925, when he sold a large air-conditioner to the Rivoli Theater in New York. By 1930 he had installed 300 units in theaters across America. Office and home air-conditioning came later as an afterthought.

Who in 1920 could have anticipated or planned the dramatic success of radios, air-conditioning, and zippers during that decade. Markets are messy and unpredictable—they defy the plans of experts and the subsidies of politicians. The exciting inventions and business successes of the 21st century will probably surprise us, too.

If Michigan's politicians will oust the experts and use low tax rates to lure entrepreneurs, that state may again see the economy boom.