



## Why Government Investments Fail

Guest: Burt Folsom

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**Burt Folsom is a professor of history at Hillsdale College and author of [Uncle Sam Can't Count: A History of Failed Government Interventions, from Beaver Pelts to Green Energy](#).**

**WOODS:** First of all, Burt, what's it like writing a book with your wife? Does this bring you closer together, or does it alienate you from each other?

**FOLSOM:** (laughs) Well, you know, I'll tell you what. Whenever you co-author a book, sometimes it can be a struggle. With Anita it proved to be a good situation. The strategy is, each of us work on different parts of the book, and then the other one comes in and edits after that. As long as we're not working on the same chapter at the same time, everything goes well.

**WOODS:** That's how I did it with Kevin Gutzman when we wrote *Who Killed the Constitution?* You stay out of my chapters, and I will stay out of yours. But then with the finished product it's as if they were both written by both of us. Nobody knows who wrote what. That's proprietary information.

Okay, before getting into the specifics here, lay out for us as you do at the beginning of the book the basic premise that you're then going to expand on via examples throughout the rest of the book.

**FOLSOM:** Right, the premise is that government subsidies for economic development have been very expensive throughout American history, and they have almost universally failed. You have two things going on at the same time. The subsidies are expensive, and they have almost always failed. And part of the secret then becomes why are they are so unsuccessful and why do we keep doing them? If we can take the government subsidies back to George Washington, we see the first ones and trace them through to Barack Obama. Subsidies for economic development are almost always a disaster.

**WOODS:** Well, let's start with George Washington, because your treatment of John Jacob Astor is very interesting when it comes to the seemingly uninteresting question of beaver pelts. It turns out this is extraordinarily interesting, because you had George Washington, who had one

attitude about trade with the Indians. and this other fellow who had rather a different attitude, and they had very, very different outcomes.

**FOLSOM:** They do, and the idea here—the Constitution in Article I, Section 8 spells out the role of Congress and what it can pass laws for and what it can't. And economic development subsidies are not really in there. So George Washington struggled with this a little bit, but for a national defense purpose he argued that we needed to keep the British in Canada and out of the United States. During his first term as president he thought it was vital for the United States to establish hegemony over the Northwest Territory. And so he argued we needed a subsidy for a fur trade company so that they would trade the furs with the Indians and prevent the British company, the Hudson Bay Company in Canada, from encroaching on American turf down into Michigan, Wisconsin, and the Northwest Territory. So we established a government-supported fur company. The problem was that the British encroachment was exactly where the fur company was. In other words, the encroachment was the worst where the fur company was because the fur company was so incompetently managed that the Indians, who are the key element in the fur trade, wanted to trade their beaver pelts with the British rather than the United States.

**WOODS:** From your book: "One reason Astor excelled was that he accepted the Indians as they were, not as he wanted them to be. If they desired axes, kettles, and muskets, he tried to find the best available and sell to them at competitive prices. He respected Indians as shrewd traders and knew he had to have the best goods to get the most business." Is there a parallel here between how James J. Hill treated the Indians and how John Jacob Astor treated the Indians, as opposed to how government sometimes did?

**FOLSOM:** Oh, there's a perfect parallel. See, Astor came in, and when the government was not doing well in its fur trade with the Indians, Astor came in—a privately operated company—who was successful. He moved the British back into Canada, not the subsidized company, and he did it for the reasons you just said in the passage that you read. He traded with the Indians. He traded them products that he knew they wanted. He had traders that lived with the Indians so he could have on-the-spot analysis of what the Indians preferred. They usually wanted axes, and they wanted knives, and guns, that sort of thing, to help them trap. Well, Astor had his agents there on the spot trading with Indians rather than asking the Indians to come to a fur trading post 90 miles away and do the trade. So Astor respected the Indians. He took them as they were and did the trade rather than trying to perfect them or trying to make them do things that they didn't want to do.

**WOODS:** Given that I drew the parallel, I want to fast forward a little bit to the James J. Hill episode. Now, some people listening here will be familiar with this story because, thanks to your telling it, people like Tom DiLorenzo, and well, I suppose even I myself, have retold the story, but you are the original teller for the modern reader. James J. Hill, of course, is involved in railroads, and he's a classic story that we're told doesn't really exist in history of rags to riches. He did not come from wealth, and he does not get government subsidies, and we're told

that means he couldn't have succeeded. How could he possibly lay railroad tracks without special government privilege? And yet he did it.

**FOLSOM:** Well, Tom, your parallel is excellent because John Jacob Astor was the same way as Hill. Both of them were immigrants. When they came to this country, they had very little. And both of them competed against government-subsidized companies, and both of them defeated those companies, with no subsidy, and they showed that the way to succeed and produce good products for consumers is to have competitive costs and in a free market rather than in a subsidized, corporatist market.

**WOODS:** What kind of subsidies would a competing railroad, or any railroad in the nineteenth century, have been getting that Hill did not get for his railroad? Which, by the way, went from St. Paul to Seattle, if I remember correctly.

**FOLSOM:** Yes, yes, and now, Hill as you say, is an immigrant. He comes over and is working in the Northwest. He doesn't get any subsidy, and he buys up a failed railroad, and he begins to slowly move it west, making each little piece of the line profitable as he goes along. Now the Union Pacific, by contrast, was paid by the mile by the U.S. government for each mile of track that it laid. Well, the Union Pacific, therefore, had no incentive to be efficient, because you're being paid by the mile whether it's a good mile or not. In fact, it was a curvaceous mile. It wasn't a straight mile, because if you curve the railroad around a bit, you could get more mileage. Hill was simply building a railroad to make a profit and to settle the Northwest, and he had to build the most efficient railroad possible, and he did so. So the Great Northern, as you point out, Hill's railroad, received no federal subsidies. It did not go bankrupt in the Panic of 1893. Union Pacific went bankrupt several times and had to be reorganized, and it was a total failure even though it received so much government money. In fact, the U.S. national debt, Tom, was \$60 million in 1860. We paid that much for the Union Pacific and Central Pacific railroads. We paid \$60 million. In other words, we doubled the national debt for a railroad that totally went broke, and we had James J. Hill all along to do it with no subsidy.

**WOODS:** Are we able to say anything about the fares that Hill charged? Because maybe they would say that, yeah, Hill managed to do this, but his fares were higher than those of the subsidized railroads.

**FOLSOM:** No, his fares were lower. See, that's the whole point. If the fares of the subsidized railroads had been competitive, they would have done better.

**WOODS:** Yeah, right, exactly. Yeah, hello! Let's back up a little earlier into the nineteenth century, because internal improvement subsidies are an area that people assume that, of course, a lot of political corruption may accompany them, and a lot of inefficiency may accompany them, but we just have to swallow hard and accept them because that's a function of government, and it can't be done in the private sector. Now, there are two areas that I want to hit on. The second one will be your discussion of Michigan, which of course, your having lived in Michigan for a while, I know you've written a great deal about Michigan. But let's talk about

what you unearthed about the National Road and the inefficiencies there. First of all, what was the National Road, and secondly, what possible problems could arise with a project like this?

**FOLSOM:** Well, it was the forerunner, I guess you would say, the early-1800s forerunner to the interstate highway system, and the idea was that we had purchased the Louisiana Territory, the Louisiana Purchase, under Thomas Jefferson, and he thought it would be good to build roads out there. In other words, that the government needed to do this. What we found was that the roads began to meander into political districts depending on the influence of the congressman. So again, it wasn't a particularly straight road. It maneuvered around depending on the influence of the Congress. So that's the first problem, and then the next problem was it was very expensive to build and because nobody owned the road, nobody had a real incentive to take care of it and people would steal pieces of the road. And so the road was a rickety road. It was terrible to drive on. The irony here is that it was developed in part, to provide mail service, that is, delivering letters back and forth into the interior of this country, and it was so poor that those people who lived near the National Road ended up hiring private couriers to deliver the mail because the National Road was such a poor expressway for traveling.

**WOODS:** Let me read again from your book. "The privately funded Lancaster Turnpike, also built with stone, cost \$7,500 per mile versus \$13,000 per mile for the National Road." Now, I don't think we need to explain to people the differing incentives that were involved. And then you said that the U.S. Postal Service found the road almost impassable and the mail therefore almost undeliverable. Many merchants along the road, in fact, had to hire private couriers to make sure their mail arrived on time. And then you say, "How ironic, using the National Road as a federal post road was the key to making it constitutional. Yet, privatized mail service regularly outperformed the U.S. Post Office. In desperation the Post Office added express mail service to try to compete with private couriers on the road, but even that often proved to be slower and more irregular than the private couriers. Angry residents along the road sent express mail letters postage due to congressmen complaining about the poor service." What a story! Nobody reads that. We read about the internal improvements projects in American history textbooks, but we don't read about that.

And what we also don't read about is the kind of story you tell about Michigan, that with the exception of the Erie Canal, they really turned out to be financial disasters to the point that some states amended their state constitutions forever to prohibit federal spending on subsidies for projects like this.

**FOLSOM:** Yes, internal improvements are played up, as you know, Tom. We both have Ph.D.'s in American history. We both went through the program. We both heard about how internal improvements at federal expense, or at least at state expense, were desirable undertakings, and here we found out when we go through the historical record that state after state that experimented with these internal improvements decided that they were so bad that they put amendments into their constitutions saying our state is not allowed to do this ever again.

**WOODS:** Well, let's talk about the Michigan case and the so-called boy governor who was 19 years old. What happened there in terms of internal improvement expenditures?

**FOLSOM:** He was—in his defense—he was a very bright 19-year-old governor.

**WOODS:** That's what makes the story so great: you have the brightest possible guy, and it still doesn't work.

**FOLSOM:** Right. Stevens T. Mason, Tom Mason, was the smartest man in the room, and he obviously put in as governor, he was acting governor at 19, and then Michigan becomes a state. So in his early 20s, he's governor of the state, and he gets this idea that it would be absolutely fantastic to build railroads from really roughly Detroit to Chicago. It seems like a no-brainer. It would be a good idea. The railroads were total disasters. They never even finished getting across the state. They both ran out of gas halfway across the state. The state was broke, and so what the state of Michigan did was to sell those two railroads to a private firm that agreed to rebuild it and finish it to Chicago at no expense to the state. In fact, they would pay the state for the opportunity to do it. Thus Michigan made part of their money back by privatizing the failed railroad.

**WOODS:** What about the major canal project in Michigan? How did that turn out?

**FOLSOM:** The canal that was built by the state of Michigan was a total disaster. It only made it a couple of miles. It cost \$350,000 to build, and it had receipts of about \$50 in its entire existence.

**WOODS:** Now, how can that be? How can it be so low? To say that's negligible is to dignify it.

**FOLSOM:** Because it was poorly built. It was not dug at a sufficient depth. It didn't have a width that allowed easy turns on the canal. And keep in mind that whenever you have state operated toll takers, you have the possibility for corruption because you don't have the same incentives in place as you would if a private company owned the line.

**WOODS:** Now, let's talk about, briefly, the Wright brothers. We know the story of the Wright brothers and the airplane a little bit, but I bet most people don't know about Samuel Langley.

**FOLSOM:** These are stories that have been lost in history and part of the reason for writing the book *Uncle Sam Can't Count* is because these stories have been lost. They are not in textbooks. Nothing we have talked about thus far in the interview appears in a typical American history textbook. The airplane is a good example. You will sometimes see textbooks talk about the Wright brothers and how they invented the airplane. The government didn't believe it was possible for a private company to do it quickly. They subsidized the man who was the expert on aerodynamics in the United States. His name was Samuel Langley. He was head of the Smithsonian Institution. He had already been an inventor. He had written a book on aerodynamics. He had honorary degrees from Harvard and Yale and Oxford and Cambridge. And he had already flown a small model plane over the Potomac. He looked like the perfect

person to subsidize. A lot of the argument here was if we delay, even if private enterprise is better than government operation, if we delay on this, the British or the Germans or the French may beat us in inventing the airplane, and that would give them the power to drop bombs on us, and we would lose a lot of our national defense ability. So the idea was if we subsidize Samuel Langley, he will invent the airplane and help us out. We subsidized Langley for two flights, both of them, in the air, and immediately into the Potomac River. They were total disasters. Nine days after the second failure of Langley, the Wright brothers, with \$2,000 of their own money, two bicycle mechanics from Dayton, Ohio, the Wright brothers, invented the airplane at Kitty Hawk, North Carolina.

**WOODS:** What's the lesson here?

**FOLSOM:** Well, the lesson is that government-supported economic development projects fail almost always, and they fail almost always because government doesn't have the ability to know who the best person to subsidize is, number one, and number two the politics of the subsidy dominate the whole arena so that the person receiving the subsidy has an incentive to perpetuate the subsidy and to undertake traditional technology. He doesn't have a subsidy to be particularly innovative. So politics are a problem, and the whole problem of finding out who really is the best operator is something that government simply doesn't have the capacity to do. But the market can do it.

**WOODS:** Burt, in the 1980s it became fashionable to talk about something called industrial policy, that it would be a good idea for government to try to distinguish between lines of production and innovation that were promising and provide it with capital because it was thought that this seems to lead to economic development around the world, and it's—we can't leave these sorts of questions entirely to private enterprise. Now that fizzled out by the end of the '80s, and I think in large part because there was a lot of good work done by some of the free-market think tanks out there showing that what you're going to have will be politically motivated decisions, and there is no reason to think they would be better than profit-seeking decisions. But just because industrial policy has sort of fizzled out in terms of fashion in Washington, does that mean that the thesis of your book is not really relevant to us today anymore?

**FOLSOM:** Oh, I think it's very relevant, because the same problems that you have in industrial policy are the same problems that you have in internal improvements. The incentives are skewed, and miscast, and so industrial policy is very likely to fail for the same reasons that these targeted subsidies have historically failed.

**WOODS:** Well, in other words, what's going on today that would make your thesis a live issue for us today?

**FOLSOM:** Well, a couple of things. First of all, we're spending, according to the Heritage Foundation, \$3,000 a second, every second, for the last 12 years on economic development subsidies. Most of the largest 100 corporations in America are receiving some. So if the policy is

not working, we need to really slow it down rather than pick it up. Second, you can cite specific industries. Ethanol subsidies are huge today. We have almost more than 1/3 of the corn crop in the United States going in to produce ethanol. Yet, that was all based on the assumption that oil was running out and the market would not be able to produce oil over a period, over a generation after the 1970s. Jimmy Carter suggested that we might run out of oil in the 1980s, and so the idea was we need ethanol as an alternative fuel because we're running out of oil. Therefore, this is part of industrial policy. But what we find is that once we have the proper incentives in place to drill for oil, which happened in the early 1980s, we get the development by George Mitchell of fracking and horizontal drilling, and although he didn't invent fracking, he developed it and put it into a fine art, and so we are able to reach oil sources today. We are able to reach those sources that we could not reach in the 1970s and '80s. Therefore, we estimate now that we have another 200 years or so of oil left to discover and pump out in the United States. Therefore, we never really needed the ethanol subsidies, because we were never really running out of oil.

**WOODS:** The book is called *Uncle Sam Can't Count: A History of Failed Government Investments from Beaver Pelts to Green Energy* by Burton W. Folsom Jr. and Anita Folsom. Burt, thanks for your time. Best of luck with this, and thanks once again for writing yet another useful book that will help us make the argument for the free society.

**FOLSOM:** Thank you, Tom. We'll put our efforts together, and we're going to change the historical profession, right?

**WOODS:** (laughs) You and me, Burt. Thanks again.