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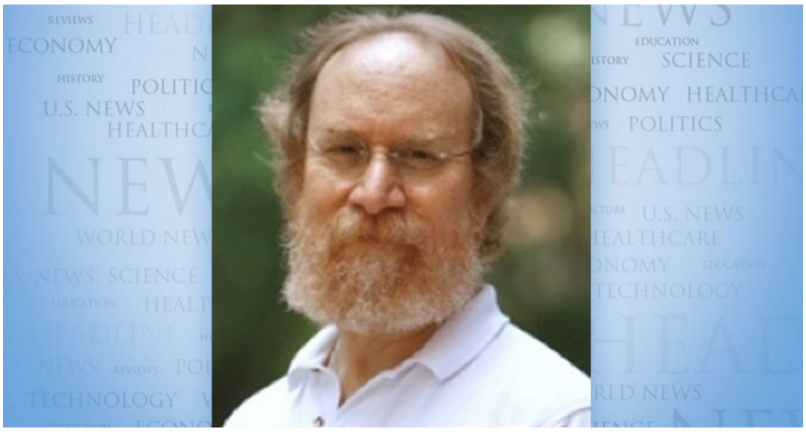
Romney and Bain Capital



Presumptive Republican presidential candidate Mitt Romney is essentially playing one card in his quest for Barack Obama’s job: his business experience taught him how economies work.

But Romney’s own pitch raises doubts about this.

The Obama campaign charges Romney with destroying jobs when he ran Bain Capital, undercutting Romney’s claim he was a job creator. Obama argues that Bain created only wealth for its investors and in fact presided over the bankruptcies leading to job losses.

I will make no judgment of Bain here. That would require looking closely at its particular ventures and sorting out allegations that it stiffed workers out of retirement and medical benefits. (To my knowledge, no one charges Bain with breaking the law or breaching a contract.)

Rather, I want to examine the claims that private-equity firms “create wealth, not jobs” and that when an acquired company is downsized or even closed, something unseemly has taken place.

A private-equity firm pools investors’ money to, as Wikipedia puts it, “provid[e] working capital to a target company to nurture expansion, new product development, or restructuring of the company’s operations, management, or ownership.” Let’s look at the restructuring aspect.

What makes such activities possible and necessary is human fallibility. Human action consists in the execution of plans in a state of uncertainty about the future. A business is not merely a loose collection of land, machines, materials, and workers. It is the embodiment of someone's plan for the future production of goods that (ultimately if not immediately) will satisfy a consumer demand. But a business plan assembled at time A may, because of new knowledge or change, look like a foolish idea at time B. If so, what should the business do? Persist no matter what? That would be futile, because it would lead to bankruptcy and extinction of the firm. Adjustment to new conditions — possibly even liquidation — is in order.

Perhaps someone outside the firm has a sounder new plan for the company. Private equity is one device for enabling outsiders to bring their ideas to companies that are falling short of their potential.

The political controversy surrounding private equity spotlights the intentions of investors. But Adam Smith's insight is overlooked: In a free market without government privilege, people seeking profit are led as if by an invisible hand to create general benefits that may be unintended.

We live in a world of scarcity — our ends exceed the means available. Resources and labor devoted to one purpose cannot be devoted to another. The price system provides the best indication of what consumers prefer among all the possibilities. But fallibility is pervasive, and mistakes will be made. If a business assembles resources and labor for purposes that time proves out of sync with consumer demand (because of, say, changing tastes or innovation), the price system provides ways to detect and correct the error.

Of course, that may mean eliminating jobs, closing facilities, or shutting down the company. This surely creates hardship for employees. But that is a consequence of inescapable features of our world: scarcity, ignorance, and change. In such a world it is entirely possible that a business will hire too many people or build too many facilities. Sticking with the plan can't be in the longer-run interest of anyone, including those dependent on the company.

If the failing company's resources are redeployed to purposes more consistent with consumer demand, new opportunities for work and investment will arise. The closing or downsizing of a company releases scarce factors of production, including labor, for purposes hitherto out of reach.

Ironically, Romney seems not to understand this. He boasts of the jobs Bain created directly, but he has yet to say his activities likely created jobs indirectly by freeing up resources and labor for new projects. This indicates a significantly shallow understanding of how economies work.

We don't live in a free market, but rather in a corporatist economy where government favors may convert activities that would serve the general interest into activities inimical to it. That's why one cannot give a priori approval to Bain. A final judgment must await close examination of its activities in light of government corporatist intervention.

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