



## Failed E-Business Deal Underscores Futility of State Economic Planning

by Michael D. LaFaive

### Summary

Government “economic development” programs attempt to guess which companies will thrive in the marketplace and create new jobs. But state officials cannot possibly understand how millions of individual consumer decisions will ultimately determine which firms succeed and which fail. That is why economic growth is best left to the free market.

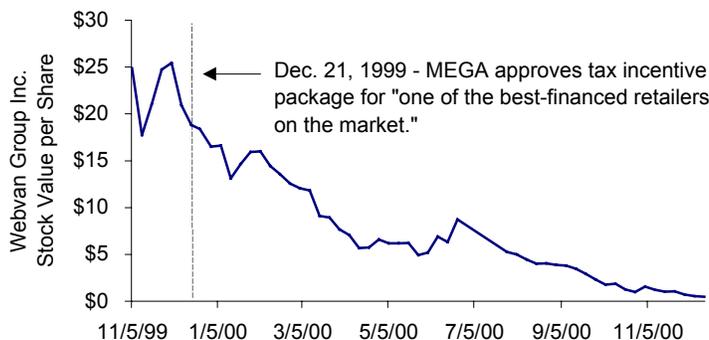
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The beginning of wisdom, so goes the saying, is the admission that there are some things we just cannot know. Some of Lansing’s economic development wizards have been humbled lately by pretending to know more than they really do.

Entire state bureaucracies are organized around the mistaken idea that government economic planners can figure out which endeavors in the marketplace will be “winners” and which will be “losers.” Decades ago, Austrian economist Ludwig von Mises and his Nobel Prize-winning student Friedrich Hayek argued forcefully that such predicting is fraught with complications and limitations. It simply isn’t possible to know and understand the myriad pieces of data, the ever-changing preferences of consumers, or the total impact of competition and technology in a vibrant, healthy economy.

But that doesn’t prevent government officials from trying. A good example is the Michigan Economic Growth Authority (MEGA), an agency created by the Engler administration in 1995 to “encourage economic development.” Part of the Michigan Economic Development Corporation (MEDC), MEGA singles out firms to shower with special tax credits, job training subsidies, and other incentives.

### State-Picked “Winner” Turns Out to Be Big Loser in the Marketplace



Source: A.G. Edwards & Sons, Quicken.com

As of November 2000, MEGA has approved 100 deals worth more than \$1.4 billion to companies that expand or relocate in Michigan. In many cases, MEGA officials can’t prove that the companies would not have expanded or relocated here without the handouts, and often the goodies simply benefit one firm at the expense of other firms that don’t get them. And in the current tight labor market, MEGA doesn’t create new jobs so much as it shuffles them from one employer to another.

Moreover, an increasing number of examples show that MEGA’s planners are stabbing in the dark. Webvan Group, Inc. of Foster City, Calif., is a case in point. An online grocery retailer, Webvan was offered \$23.4 million in tax credits by MEGA on Dec. 21, 1999, in exchange for the company’s promise to build

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one of its 26 warehouse distribution centers in Michigan. The company's stock finished that week at \$18.38 per share.

Webvan was supposed to be a big winner. Doug Rothwell, MEDC president, told Site Selection magazine in May 2000 that "Detroit was picked by one of the best-financed retailers on the market for the next wave of e-retailing." State officials heralded the Webvan-MEGA deal as wise policy and a win for Michigan.

But a funny thing happened on the way to the bank. Webvan's stock began a steady descent almost immediately following the MEGA agreement, reaching an all-time low of \$0.47 per share on Dec. 15, 2000. The stock has lost more than 97 percent of its value since Webvan was approved for MEGA credits. The company withdrew its promise to build a distribution center in Michigan, forfeiting the MEGA tax credits.

Why did state officials fail to predict Webvan's difficulties? MEGA regularly issues reports purporting to forecast exactly how many jobs will be created by its tax credits, even 20 years into the future. The answer is simple: the knowledge problem again. Entrepreneurs putting their own money on the line have more reason to predict correctly than anyone, yet even they fail most of the time. For government planners playing with the taxpayers' money, this sort of economic prediction is a pipe dream.

As it turns out, according to Security and Exchange Commission filings, Webvan officials dumped almost 2 million shares of their own stock between Feb. 1 and Oct. 30, 2000. Apparently, Webvan knew something MEGA officials did not: Online grocery shopping wasn't the success its boosters expected.

Maintaining a government department that hands out special favors to certain businesses and not to others is unfair. But it may also hurt the state's real rate of economic growth. Harold Brumm, an economist with the General Accounting Office in Washington, D.C., says companies devote substantial resources to securing government favors, and that this has a "relatively large negative effect on the rate of state economic growth." In other words, without discriminatory favors, Michigan's economy might be doing *better* than it is.

The overconfidence of economic planners is why the economies of the old Soviet empire failed. It's why no government agency could have planned for the rise of the computer or auto industries, and why so many government enterprises require huge subsidies to stay afloat. The "invisible hand" of the free market, imperfect though it may be, will almost always produce outcomes superior to the presumed wisdom of government officials spending other people's money.

Government bureaucrats picking winners in the marketplace is no more scientific than throwing dice. But dice are a lot cheaper.

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***Maintaining a government department that hands out special favors to certain businesses and not to others may actually hurt Michigan's real rate of economic growth.***

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