



WHY IS AMERICA SO RICH?

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The United States is the world's most prosperous economy. It's been that way for so long -- over a hundred years -- that we take it for granted. But how did it happen?

There are many answers, of course. One is that the United States values the free market over government control of the economy. But here's a point that is seldom made: It didn't begin that way.

Before the country placed its trust in the free market, it trusted the government to make important business decisions. Or to put it another way, only after the government failed repeatedly to promote economic growth, and only after private enterprise succeeded where the government failed, did the United States start to develop a world-beating economy.

Let's look at three telling examples:

In 1808, John Jacob Astor formed the American Fur Company and marketed American furs around the world. Europeans adored beaver hats for their peerless warmth and durability. Astor gave them what they wanted. Instead of leaving the fur business to capable entrepreneurs like Astor, the government decided it wanted to be in on the action. So, it subsidized its own fur company, run by a self-promoting government official named Thomas McKenney. McKenney should have won the competition. After all, he had the federal government backing him. But while Astor employed hundreds of people and still made a tidy profit, McKenney's company lost money every year. Finally Congress, in 1822, came to its senses and ended the subsidies for McKenney and his associates.

A similar situation developed in the 1840s around the telegraph.

The telegraph was the first step toward the instant communication we have today. Invented by Samuel Morse, the telegraph transmitted sound as dots and dashes, representing letters of the alphabet. Morse, more of an idealist than businessman, agreed to let the government own and operate the telegraph "in the national interest." But the government steadily lost money each month it operated the telegraph. During 1845, expenditures for the telegraph exceeded revenue by six-to-one, and sometimes by ten-to-one. Seeing no value in the invention, Congress turned the money-loser over to private enterprise.

In the hands of entrepreneurs, the business took off. Telegraph promoters showed the press how it could instantly report stories occurring hundreds of miles away. Bankers, stock brokers and insurance companies saw how they could instantly monitor investments near and far.

As the quality of service improved, telegraph lines were strung across the country – from 40 miles of wire in 1846 to 23,000 miles in 1852. By the 1860s, the U.S. had a transcontinental telegraph wire. And by the end of that decade, entrepreneurs had strung a telegraph cable across the Atlantic Ocean.

Why didn't the U.S. government profitably use what Morse had invented? Part of the answer is that the incentives for bureaucrats differ sharply from those of entrepreneurs. When government operated the telegraph, Washington bureaucrats received no profits from the messages they sent, and the cash they lost was the taxpayers', not their own. So government officials had no incentive to improve service, to find new customers, or to expand to more cities.

But entrepreneurs like Ezra Cornell, the founder of Western Union, did. Cheaper, better service meant more customers and more profits. Just fifteen years after Congress privatized the telegraph, both the costs of construction and the rates for service linking the major cities were as little as one-tenth of the original rates established by Washington.

In the steamship business, we see the story repeated yet again. During the 1840s, regular steamship travel began between New York and England. The government placed its bets on ship owner Edward Collins, a man more skilled at political lobbying than at business.

While Congress funded Collins, Cornelius Vanderbilt started his own steamship company. Vanderbilt cut the costs of travel, filled his ships with eager passengers, and built a fabulously successful business, soon leaving Collins in his wake.

Collins failed because he didn't feel a need to improve, or even provide safe and regular service (for example, two of his four ships sank, killing hundreds of passengers). If he lost money, there was always another politician to appeal to. Vanderbilt, in contrast, had to serve his customers or he would have lost his company.

You'd think we would have learned our lesson by now: economic prosperity comes from free enterprise, not from government subsidies. But it's a lesson we have to learn every generation.

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