Out of the Mouths of Babes

By John Hasnas

Those engaged in political disputation will often assert that what they contend "is so obvious that even a child can see it." This statement is usually made for rhetorical purposes and is not meant to be taken literally. However, I was recently engaged in a discussion in which the solution to the problem under consideration really was so obvious that a child could see it, and interestingly, only a child did.

In a recent speech, President Obama proposed lowering the corporate tax rate in return for increased spending on a list of items that included biofuels and electric cars. Several of my fellow professors and I were discussing this speech at my home when the conversation turned to the Obama administration's poor record of investing in green energy companies. The $535 million loan guarantee the U. S. Department of Energy gave Solyndra, now bankrupt, and the $529 million loan guarantee it gave to Fisker Automotive, soon to be bankrupt, were offered as supporting evidence.

With a sigh, one of my colleagues quoted Milton Friedman's aphorism that "nobody spends somebody else's money as carefully as he spends his own." My eleven-year-old daughter, who was nearby and overheard this remark, interjected, "Then why not have the people who decide where to invest taxpayers' money invest some of their own money as well?"

Why not, indeed? The silence that followed my daughter's remark indicated that we all recognized that she had made an entirely reasonable suggestion.

In 2010, Congress passed the Dodd-Frank Act, which requires those who create asset-backed securities to retain at least 5% of the credit risk associated with those securities. Apparently, federal policy is to discourage financial institutions from taking foolish risks by requiring them to have some "skin in the game."

But if this is a good way to discourage poor investments by private parties, isn't it also a good way to discourage poor investments by government? Federal officials who make disbursements are spending other people's money.

If the federal government is going to act as a venture capitalist, why shouldn't those charged with making investment decisions be required to have some skin in the game?
Won't federal officials who are required to invest some of their personal capital along with the taxpayers' be more likely to exercise diligence about the economic fundamentals of the investment and less likely to be influenced by political or ideological considerations?

The requirement that federal officials put some of their personal wealth at risk need not be a hardship for them. Perhaps a yearly bonus for each official authorized to make investment decisions could be placed in escrow. Some portion of this amount would have to be invested in any company that the official selects to receive taxpayer funds. At the end of the year, or better, at the end of a multi-year period, the official would collect either the augmented or reduced proceeds of the escrow account as his or her bonus.

To make this incentive system even more effective, it can be applied not only to those who make the initial investment decision, but also to all others up the administrative chain of command who have to sign off on it.

This proposal should have bipartisan appeal. Liberals who favor federal investment in green technology would certainly want to get the most bang for their environmental buck. The last thing they want is more Solyndras. And even conservatives who oppose investing taxpayers' money in private ventures at all would agree that if such investments must be made, they should be made wisely. Democrats and Republicans may have radically different ideas about what the government should do, but whatever it does, neither party wants it done wastefully.

It is difficult to see a basis for objecting to my daughter's proposal. It appears to be a simple, sensible way to align the incentives of those acting as agents for the taxpayers with their taxing principals, and bring a bit of efficiency to government to boot.

Perhaps the solution to some political problems really are so obvious that even a child can see them. It is too bad that this does not guarantee that they will also be perceived by our elected representatives.