Small Is Beautiful

Memo to GOP: Think less about corporate America, more about startups.

BY DAVID SMICK

In late 1979, during an economic strategy meeting, Ronald Reagan was talking about his upcoming presidential campaign. At one point, somebody expressed concern that John Connally, the former governor of Texas and another presidential candidate, was gaining support among corporate chief executive officers, with all the financial support and credibility that that entailed. Reagan said this didn't bother him at all. "Let him have the Fortune 500," he said. "I want our campaign to stand for Main Street, not Wall Street. I want us to stand for the worker, the shopkeeper, the entrepreneur, and the small businessman." Reagan's instincts were right on the mark.

Last week, House Republicans announced a "pro-growth" agenda that concentrates on corporations. The plan lowers the top corporate tax rate while eliminating loopholes as a means of helping reduce today's horrendous joblessness. Sounds logical; big corporations such as General Electric pay no taxes while other less politically connected firms pay the full freight. The playing field, therefore, needs to be leveled. Plus, the U.S. corporate tax rate is uncompetitively high by international standards.

Yet the GOP should be wary of becoming the political face of corporate America. The same goes for those Republicans who lately have been defending Wall Street's incompetent, too-big-to-fail bankers.

Instead, Republicans should concentrate on reforming the *individual* tax schedules. Listening to the Washington debate, you encounter a troubling misperception that individuals merely consume while corporations create economic growth and net new jobs. In other words, "capital" precedes, and is more important than, "labor." Certainly capital is important. But as Abraham Lincoln said, "Capital could never have existed without labor."

Individuals (i.e., human capital) are essential to reigniting the dynamism of the American economy. People are the economy's essential producers, savers, investors, and innovative risk-takers—as well as consumers. People are the prime players in Schumpeter's bottom-up process of creative destruction. Reforming the *individual* tax code, therefore—by lowering personal tax rates while eliminating special interest tax shelters as a means of mobilizing these creative individuals—is the key to reducing joblessness.

The administration's approach to job creation calls to mind the old joke about the guy on hands and knees under a lighted lamppost down an otherwise dark alley. He is desperately looking for his lost car keys. When asked where he last saw the keys, he points to a nearby dark corner. "Then why aren't you looking there?" is the logical next question. To which the guy on hands and knees responds, "Because the light's better here."

The administration has looked to the Fortune 1000 for job creation because the light's better closer to corporate America. Last January, when the White House needed someone to head up a new jobs council, they named the CEO of General Electric even though data show large corporations are by nature net job eliminators. Witness the 34,000 American jobs lost at General Electric between 2000 and 2009.

Meanwhile, over in the dark corners, new small businesses are starting up. These firms create the vast majority of net new jobs. Picture a highly unpredictable, boiling cauldron of winners and losers engaged in fierce competition. That's the definition of a vibrant, job-producing economy. Some of these new firms produce society-transforming technologies. But most provide everyday services, sometimes with specialized niche products ignored by corporate America. Most of these highly risky startups fail, but others spring to life to take their place. The net result is an expansion of the job base.

American joblessness has reached heartbreaking levels for largely one reason: Who in their right mind in today's highly uncertain tax, regulatory, monetary, health care, and geopolitical environment would take the risk of striking out with a new venture? New enterprises flourish in a climate of abundant liquidity and confidence—exactly the opposite of today's conditions. Everyone in the risk capital community, moreover, knows that the likelihood of a new venture achieving a public stock offering in today's climate of caution and pessimism is strikingly low. That's why risk capital is so hard to come by. And forget about using government funds to pick the innovative winners from the losers. That's a fool's errand.

So U.S. unemployment is likely to remain high, which is a prime reason the 2012 GOP presidential nomination still retains considerable "value." True, the unemployment rate in recent months has come down, but most of the improvement has been the result of discouraged workers exiting the labor force. Today one in five American men are without jobs. Among people aged 16-19, the unemployment rate is a stunning 24 percent. With the price of gasoline at $4 or $5, 2012 could become a real political horserace despite President Obama's advantages of incumbency.

But Republicans would be wise to pivot on the corporate tax issue. The 2012 presidential race should pit the "small" and the "new" against the "large" and the "well-connected." It should be a contest between the small town populist and corporate elitist models of America's future.

This transition is likely to be more difficult than anticipated. That's because, with one exception, every economic player in Washington has a lobbyist. The one exception? Those innovative, job-creating firms that are yet to come into being. They exist only in people's dreams and imaginations. These innovators are America's only hope for pulling out of today's economic mess, and they desperately need someone in Washington to champion their cause. ◆

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