NAKED FAVORITISM

A highway's history of the state economy

MACKINAC CENTER
FOR PUBLIC POLICY


25
Bay City
EXIT 140B
NORTH
75
23
Mackinac Br
EXIT 1/4 MILE
EXIT 140A
SOUTH
75
23
Saginaw
EXIT ONLY
ENDS
10
BRIDGE ICES BEFORE ROAD
RIGHT LANE MUST EXIT

U.S. 10

US Route 10, which spans from Ludington to Bay City, is often considered where Michigan's "Up North" begins. The stretch I drive most often is between Midland and Bay City, where US-10 meets I-75. The scenery is mostly farmland, but if you pay attention, the drive tells an important story about Michigan's economy. Several prominent buildings that stick out among the corn fields show how the state's economic strategies have shifted.

The first large facility as you drive eastbound from Midland on US-10 is a massive complex owned by the Dow company. This corporation made Midland what it is. Founded in 1897, Dow achieved early success by pioneering efficient ways to extract and process bromine. The company survived fierce competition in the chemical market in the early 20th century, especially from British and German companies.

But Dow grew steadily and positioned itself to be in the right place at the right time. During World War I, the company supplied the U.S. government with many materials it previously had imported from Germany. It was an important supplier of magnesium in World War II, which was needed in large supply to build military planes. And, infamously, it fulfilled the U.S. government's order for napalm during the Vietnam War.

Through it all, Dow succeeded by repeatedly creating valuable products that consumers demanded. It consistently found new ways to create superior quality or to reduce costs. While the company occasionally unfairly benefited from subsidies and tariffs and other trade restrictions, its story is overwhelmingly one of earning profits by meeting the demands of consumers and outcompeting other firms in the market.

Dow's model of economic development used to be the primary lens through which Michigan policymakers viewed their role in the economy. It's mainly a hands-off approach, with the state's role limited to enforcing contracts and discouraging fraud with a minimal regulatory regime. The competitive pressures to win customers in the market handle the rest.

The next facility you see along this stretch of US-10 is the sprawling campus of one of the state's largest alcohol distributors, Fabiano Brothers. Like Dow, this company has deep roots in mid-Michigan, but its rise followed an altogether different path.

Dow

Michigan law creates a convoluted "three-tier" system for regulating the sale of alcohol. It creates regional monopolies for distributors. This supposedly benefits consumers and protects public health, but it's not clear how. The rules were devised in the Prohibition era, so maybe they made sense then. Today, this system ends up raising prices for consumers and kills other potential distribution jobs without protecting public health or safety.

The Fabiano Brothers distributing company owes its success, at least in part, to the monopolistic privileges the state granted it. That's not to say there isn't a lot of hard work, entrepreneurship, business savvy and a bit of luck involved, but owning a state-enforced monopoly provides the company protection from normal market competition, the type that most others repeatedly have to overcome.

The alcohol distribution scheme represents a second type of economic development strategy Michigan has used: tight, market-defining government regulations. These exist in markets for goods and services where the government has taken a dominant role for one reason or another. Electricity is another example. Michigan law essentially hands a monopoly to two companies. Residents and, with a few exceptions, industry have little or no choice about where they buy their electricity. Consumers Energy and DTE face little market competition and, in fact, are specifically protected by the government. It is little surprise that Michigan has some of the highest energy costs with the worst service in the United States.

Health care is another industry defined by government favoritism. Certificate of Need laws are a good example. The commonly used acronym for these laws may say it all: CON. Certificate of Need laws require potential health care providers to get approval from a Lansing commission before they build new medical facilities, provide more hospital beds or even use certain types of equipment. Sitting on the commission are representatives of current medical centers and hospitals. This provides them with a golden opportunity to limit their competition.

Selling cars in Michigan is also rife with protectionist rules. Sellers are protected from nearby competition. A variety of state regulations abruptly imposed in 2004 killed 850 small businesses quickly, while larger companies were better equipped to deal with the changes. Sunday sales are against the law. Consumers can't even legally buy vehicles directly from a manufacturer, as they can with many other products.

Occupational licensing laws are another attempt to micromanage a private market. Lawmakers dictate who is allowed to do certain jobs through these licensing mandates. They now affect nearly one in five

Fabiano Brothers

workers in Michigan. It's often hard to justify these arbitrary and inconsistent licensing laws. State law requires a license for installing concrete, insulation and masonry, but not for asphalt, drywall or carpet. School librarians need a college degree while town librarians don't even need a high school diploma. Selling garlic, doughnuts or cookies requires a license, but not apples, eggs or cabbage.

Why the differences? Licensing laws largely come into existence because they are pushed by existing businesses, who want to lock out potential competition. That's why the state's books contain a hodgepodge of laws controlling who is legally allowed to work in certain industries.

Further down US-10, right next to Fabiano Brothers, is a new building owned by SK Siltron, which manufactures material for semiconductors. This is a large and growing industry, especially with the continued growth of electronics. We might expect to see more of these types of companies pop up organically. But that wasn't the case with this company. It was heavily subsidized by the state and federal governments. Some politicians are concerned about the semiconductor supply chain and have sprung into action, granting favors to some firms operating in this industry. SK Siltron received tons of state and federal subsidies, including a $1.5 million "business development" grant and a local property tax abatement.

In fact, Gov. Gretchen Whitmer claims that SK Siltron only resides along US-10 near Bay City because of her. She "fought to secure this investment," according to one of her press releases about the project. The state subsidized four other companies active in the semiconductor supply chain.

SK Siltron represents a third economic strategy Michigan policymakers engage in, and one that is growing more common. In addition to crafting complicated regulations to control markets, politicians are simply subsidizing favored industries and businesses. These subsidies provide several benefits to politicians and to the handpicked companies receiving them. There's always a ribbon-cutting or ground-breaking or press release in the newspaper. By paying these companies with other people's money, politicians can claim with a straight face that they helped create a new, shiny facility and the jobs that will go along with it.

If there's one thing Michigan politicians from both parties have consistently agreed on, it's handing out money to favored companies and industries. Lawmakers approved $4 billion in select incentives just last year, which went out to just a few politically connected corporations. Taxpayers have spent more than $20 billion on special business favors this century, with much of it wasted. The

SK Siltron

lucky companies often fail to create the jobs they promised, and many just fail altogether despite the state freebies. Much of this money has gone to established industries (the Big Three automakers, large property developers) or speculative new entrants (battery makers, green energy companies).

It used to be that governments subsidized industries they wanted to help — think of President Franklin Roosevelt trying to help farmers during the Great Depression or the tariffs put on foreign cars to help the Big Three. But now politicians take the opposite approach: They subsidize industries and companies they claim are the next big thing. Many of these companies appear to be doing fine all on their own. But even in a high-demand industry like semiconductor manufacturing, taxpayers must cough up some dough to help. Most of this money is also likely wasted, at least from a state taxpayer's perspective. If politicians are right about these companies, they shouldn't need taxpayer support to survive.

Politicians subsidize much more in the hope of growing the economy. Lawmakers appropriated $500 million to dozens of films and studios with hope of growing in industry (it was an artistic and economic flop and the program died). And to the tune of about a billion dollars each for the past few years, Michigan lawmakers have doled out pork to local businesses, nonprofits and government agencies. Many of these are for uncontroversial services — art museums, Little League programs, civic arenas, etc. But the process is wholly inappropriate — there is no objective process to determine which of countless organizations around the state is the most deserving of public money. Lawmakers pick one curling center over a nearby competitor and one Little League over all the others, based, presumably, on little except political influence. All taxpayers pay, while the districts with the most influential politicians see nearly all of the benefits.

This view along US-10 tells a story of Michigan's past and current economic strategies. Of course, the reality is more complicated. Michigan policymakers have dabbled with all three of these strategies to some extent in our state's history. The Great Lake State almost went bankrupt in its early years by trying to finance railroads and canals, whose costs grew out of control. Voters were so disgusted by this episode that they passed a constitutional amendment to forbid all state investments in private enterprise. The state's economy grew significantly in the following decades.

It's probably not a coincidence that after policymakers were forbidden from messing with Michigan's markets in this manner, the state birthed some of its great entrepreneurs, the likes of Ford, Kellogg, Dodge, Durant and Dow. The companies they built

largely arose despite, not because of, government rules and regulations.

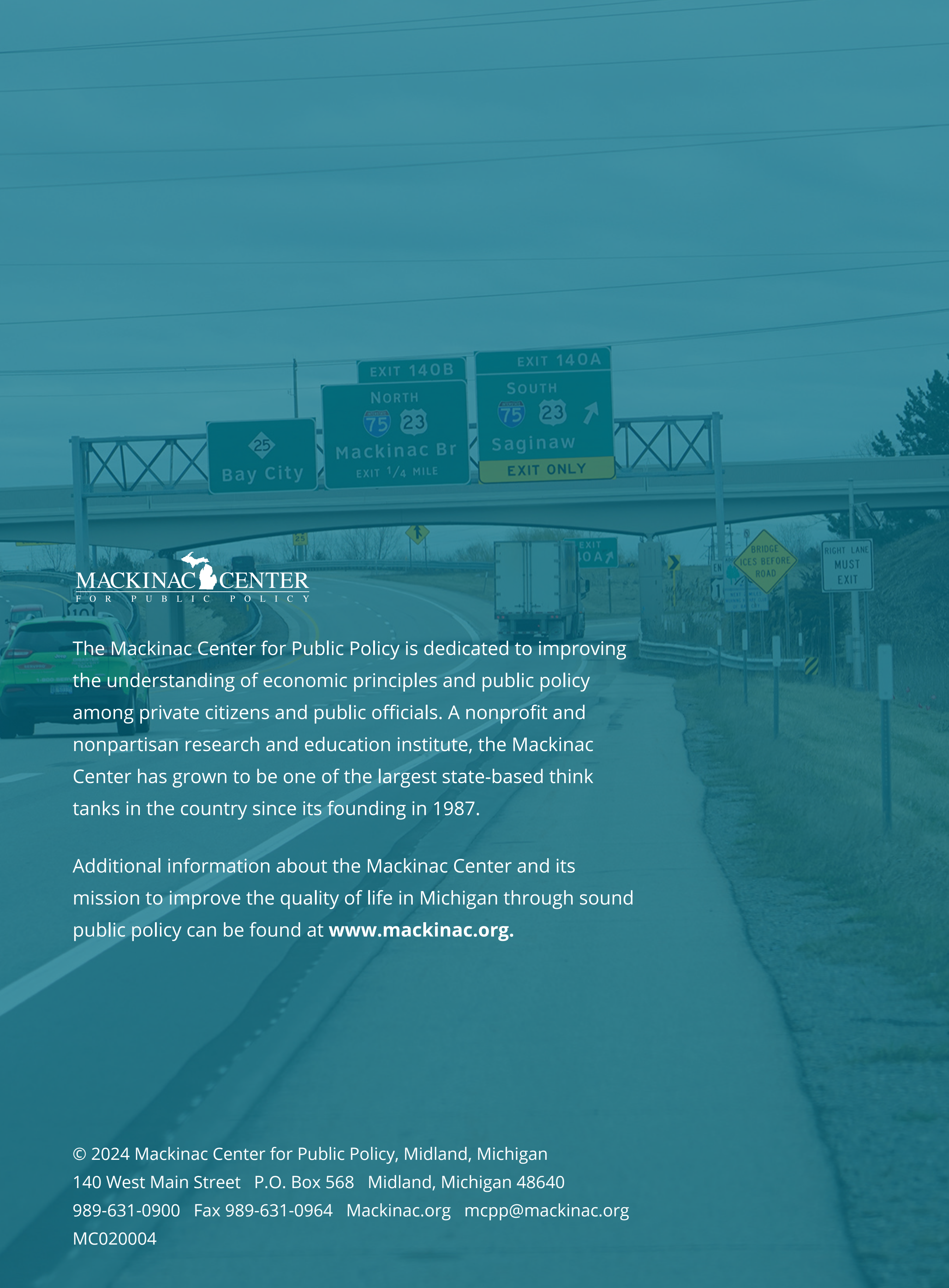
And, of course, Michigan still has plenty of great businesses and entrepreneurs. But their efforts are increasingly being spent navigating regulations or, worse, advocating for government favors. I fear that naked favoritism and rent seeking is becoming Michigan's main economic strategy, ingrained in Lansing as the only way to "do something" about jobs and the economy.

Rent seeking means to take advantage of government laws and policies to grow one's wealth, rather than competing in the market. It is seeking rents from the government rather than focusing on success through market entrepreneurship. Based on news releases from the state, one could easily start to believe that the state economy grows only if our wise politicians and bureaucrats make the right investments.

Government can do better than handing out favors to some at the expense of everyone else. It is a democratic ideal that the people's representatives ought to care most about improving the quality of life for everyone.

The effort required to turn Michigan back from favoritism and toward a system that allows individuals and industry to thrive through competition and enterprise is enormous. It requires men and women of principle, not just as politicians, but also voters, supporters and civic leaders.

This type of effort right-sized Michigan in the 1800s. Back then, Michigan was on the brink of becoming a failed state. Instead, it became a giant of the 21st Century. That can happen again.



MACKINAC CENTER
FOR PUBLIC POLICY

The Mackinac Center for Public Policy is dedicated to improving the understanding of economic principles and public policy among private citizens and public officials. A nonprofit and nonpartisan research and education institute, the Mackinac Center has grown to be one of the largest state-based think tanks in the country since its founding in 1987.

Additional information about the Mackinac Center and its mission to improve the quality of life in Michigan through sound public policy can be found at **www.mackinac.org.**

© 2024 Mackinac Center for Public Policy, Midland, Michigan
140 West Main Street   P.O. Box 568   Midland, Michigan 48640
989-631-0900   Fax 989-631-0964   Mackinac.org   mcpp@mackinac.org
MC020004