Creative Investment in the Black Community

By Paul L. Pryde, Jr.

A few weeks ago the National Urban League (NUL) released its annual lamentation regarding the condition of black America. But unlike some of its past reports, this time the Urban League suggested a way to deal with the problems. The National Urban League called for a domestic Marshall Plan.

As a black man who has been around for a number of years, I can personally attest to the fact that this proposal is more than twenty years old. It was originally introduced by the late Whitney Young, a past president of the League. Now, as I advance in years, I am far from saying that age ought to disqualify anything or any idea from consideration.

Yet it seems to me that if this proposal could not be enacted when American economic power and white guilt about the condition of black America were at their zenith, it does not stand much of a chance of passage today. I do believe, however, that the Urban League is on to something. And that something is the fact that the biggest problem facing African American communities today is the lack of investment. But the problem with the NUL proposal – and I want to address what should be done later on – is that it addresses the wrong type of investment, financed the wrong way.

Examining the NUL Marshall Plan

The Urban League proposal, the domestic Marshall Plan as it is called, would essentially be aimed at financing infrastructure. There is nothing wrong with financing infrastructure. Anybody who has looked at decaying roads, bridges, and highways in this nation's cities would agree that something needs to be done. But rebuilding infrastructure is not the strategy for rebuilding black America.

As any economist can tell you – and they agree on very few things, but this is one of them – the American economy is undergoing a fundamental restructuring as a result of international competition and rapidly changing technology. Economists also agree that in order to meet this competitive challenge, the U.S. economy must have both a high degree of flexibility and a high degree of productivity.

In other words, the U.S. economy has to be able to produce existing goods with increased efficiency and it has to be able to produce new goods to replace the goods that become obsolete, either technologically or economically. In order for the American economy to respond in the necessary fashion, increased investment will be needed – investment not in infrastructure so much, but in human capital. Further, there is a lot of evidence that human capital investment is the most important type of investment a society can make in its economic growth *and* its economic progress.

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Investing in Human Capital

An economist at the Brookings Institution estimates that 75 percent of the nation's growth over the last fifty years can be attributed to investments in human capital. Investment in such human capital as education, training, the GI Bill, and similar types of initiatives.

The Office of Technology Assessment, a respected organization, has reported that U.S. international competitiveness depends on a highly educated labor force consisting of people who are going to be able to change jobs seven or eight times in a lifetime. The sort of society that most economists agree the United States needs to be is one that is highly productive, which means a lot of people producing more goods more efficiently; and highly flexible, which means a lot of people being able to invent and create new goods and produce new ways of producing those goods.

Economic investment, therefore, should focus on workers who can produce those goods — workers and managers — and their education and training. But investing in inventors and entrepreneurs also is essential. These are people who are going to develop new economic arrangements and new products and services.

Igniting Entrepreneurship

As a matter or fact, throughout the economic literature there is a general consensus that entrepreneurship is the engine of economic progress. And as described in a recent book that Shelly Green and I authored, *Black Entrepreneurship in America*, it is clear that a community's economic well-being is heavily dependent on its level of business participation.

If you look at the data, groups with high levels of business participation have high levels of income. Groups with low levels of participation have low levels of income. It is true throughout this country — indeed, the world.

Entrepreneurship, therefore, is essentially the engine that *drives* economic progress. And it is a very important form of human capital investment. When you invest in a young company you are investing in the creative capacity of the founders and the entrepreneurs. The people that are founding that company are going to produce a new product, a new service, or a new way of producing old products and services.

Now, one could conclude that the thing to do, then, is just change the Urban League proposal a little bit and target it to people rather than real estate. However, that would actually be wrong. The problem is that we have reached the point of diminishing returns with government-managed programs. There are certain types of investments that just are not appropriate for government. For example, studies show that entrepreneurs get most of their money, not from government loan programs, but from their friends, family members, and business associates. Governments do not make good risk-takers. And if you think about it, those of you who understand public service, it follows that upholding the public trust and taking risks are often incompatible.

Returning briefly to the Urban League proposal. One of the things that it lacks is the spirit of innovativeness that has characterized the ideas upon which the economic progress of the African American community is based. If you look back, the leadership of the African American community, those who have been most important in our progress, have been the innovators. They have been the Thurgood Marshalls, the Martin Luther Kings, the Malcolm Xs, the A. Philip Randolphs, the Marcus Garveys.

These have been people who have recognized that, essentially, the African American community has got to use its own resources to solve its problems. They didn't eschew government help, but looked to government to create conditions under which African Americans, black Americans, themselves, could solve their problems. We need to return to that sort of innovative spirit.

An Appropriate Role for Government

I have had the fortunate – some would say unfortunate – experience of having helped design some government loan programs. Invariably, with these programs, a couple of things happen. If you make a loan to somebody and the loan goes bad, you are accused of making a loan that wasted taxpayers money. The critics will claim that anybody should have known better than to make such a bad deal.

On the other hand, if you make a loan to somebody and the fellow makes a lot of money, or the company makes a lot of money, then you are accused of making a loan that a commercial banker should have made. The critics will accuse you of enriching somebody at the expense of other people who certainly could have used the taxpayers' money more productively.

Thus, the prudent thing for any public servant to do with a government-financed program is to do very little at all. Don't make anybody rich, don't lose too much money, and certainly don't make any money. That is not a formula for economic progress. Rather, the sort of investment needed must be made by private individuals who have a stake in the success of the companies that they finance.

There are other types of investments that also are not appropriate for government. The decision to invest time, which is key to the development of children in our society – with respect, for example, to spending time on their schoolwork – is a decision that government can't make for individual families or individuals themselves. Likewise, the decision to invest in college education is a private decision; it, too, can't be made by government. So, not only is government becoming less and less capable of making important investment decisions, there are certain decisions they ought to stay out of as a matter of general public consensus and basic common sense.

Now, it seems to me, if the necessary investment – perhaps as much as $50 billion – is not going to be financed by government, it has to be financed in another way. I have identified what I believe are three obvious elements of such an investment plan.

Of course, these strategies are not usually considered investment opportunities. The first is Social Security reform. Surprising idea, novel notion, but I will explain why I think that it is important. The second is tax and regulatory incentives to increase savings. And the third is privatization. Those are the three elements that hold the possibility of injecting into the black community the sort of investment that is really needed.

Reforming Social Security

Let me talk a little bit about Social Security. I am surprised to see that it has become an issue. But it is a very important issue for African Americans because, according to the National Center for Policy Analysis, Social Security is an absolute disaster for blacks. The reason is that black Americans, generally being low-income, pay a higher percentage of their income in Social Security taxes than most Americans. And because we die at earlier ages we receive less in Social Security benefits than other people.

So, if you want to be really negative about it you can say that Social Security is a transfer from low-income blacks to high-income whites. Now, there is another problem with Social Security, as everybody has pointed out recently. Surpluses in Social Security are invested in government bonds, which transfer the burden of financing a lot of government programs from higher-income people to lower-income people. Not a very good idea. And it is an idea that a lot of people think is inequitable.

Representative John Porter of Illinois and others have come up with what I think is a novel and good idea for privatizing Social Security. Over time, they would create worker-owned retirement accounts that could be invested in the private economy rather than, as is now the case, in government bonds.

For blacks, there are immediate benefits to the Porter-type plan. One is that instead of being taxpayers and using Social Security payments only to fund the current benefits of current retirees, workers become asset holders. So, immediately you would have an increase in the wealth of the black community. Presumably, within certain reason, these funds could be invested in obligations and assets that are important to the black community. For example, it could be invested in deposits, insured deposits at black banks or other banks, and invested in the black community. They could be invested, for example, in SBA guaranteed obligations, which are federally guaranteed obligations issued by small companies, and other sorts of investments that would create additional income and additional jobs in the black community.

In addition to Social Security reform, there need to be incentives for people to invest their savings in a certain way. One of my beliefs is that black Americans who have money behave just like white Americans who have money. That is, they will invest in things that they would not otherwise invest in only if you give them the incentives to do so. Now, that might not be smart. It might not be morally right. It may not be the way we would like it to be. But I am absolutely certain that that's the way it is.

Creating Tax and Regulatory Incentives

Therefore, in addition to Social Security reform, we need tax and regulatory incentives for people who want to invest in the African American communities. Incentives are needed for African Americans and others who also want to invest in those communities, to hold their savings in certain forms. For example, incentives to invest in the stock of companies that create jobs in poor communities would be a useful strategy.

There is a tendency, as I mentioned earlier, for African Americans to want government to finance most of our development. But it is also a fact that currently there are pension funds with around $30 billion in assets, most of whose beneficiaries are black. I happened to talk to a fellow who managed one of those pension funds and I asked him, "You have got about a $2.4 billion pension plan, 70 percent of whose beneficiaries are black. How much of that money goes into the black community in the form of investment?" "None," he replied. "Why?" He never thought of it. Well, I find that appalling.

I recognize that there are laws that say that you cannot put the retirement income of people at risk by putting them in risky assets. But it seems to me that if you take one percent or two percent of the assets of those pension funds and were to lose it all, the impact on the overall rate of return on the pension fund would be absolutely negligible. It would not make a bit of difference. So, we need to create incentives for pension funds and other sources of wealth that are owned by the black community, but managed by others, to be invested in ways that are productive of economic activity in those communities. Put a little bit differently, it seems strange to me that a community that is begging for investments, and so badly needs investment, is a net exporter of its capital. But because of the rules of the game – the way things are currently structured – we need tax and regulatory incentives to encourage us to use our own wealth to create more wealth.

Privatizing Public Services

Finally, the third element of my investment proposal is privatization. Now we all know large parts of the public sector are inefficient. Services are not nearly as efficient as they ought to be and they cost a lot more than they should. We also know that blacks are heavily represented among the management of public services. So, I think we ought to introduce competition, private competition in the management of public services.

For example, in the area of education, teachers ought to be able to form little cooperative organizations to manage schools under contract with local government agencies. This approach has been tried in certain places with some pretty stunning results. And to those who would say, "Well, that's sort of risky." I would say, "Well, better to risk the possibility of success than to continue along a path you know will fail."

Another area in which we ought to be thinking more creatively is privatization of prisons. One of the largest sources of human capital – underutilized human capital – in this country is in our prisons. The largest percentage of the prison population is made up of blacks who are warehoused. At the same time, we have an American society that is not competitive in foreign markets because labor cost is too high. Why shouldn't we be training and investing in the development of prison labor to produce products that are no longer produced in the United States and whose production, by prisoners, would not at all jeopardize existing jobs.

Once again, investment of this type can solve a couple of problems. It certainly can help contribute to a reduction of the foreign payments deficits. And it would certainly reduce the net cost of prisoners by creating an enormous investment in people who need it very badly.

Now, John Jacobs, current president of the Urban League, when he proposed that we have a domestic Marshall Plan, spoke of a figure of $50 billion. I have no idea whether that's a legitimate number or not. I do know one thing, however. A $50 billion plan – a plan with a $50 billion number – would not produce a net investment of $50 billion in the black community. It would likely have to be intermediated through endless politicians and government agencies. So we might see $5 billion or $10 billion ending up in assets in the black community itself.

I recently had an opportunity to read an article by Peter Drucker, who pointed out that one reason for the Japanese miracle after World War II was that the Japanese government, in the late forties, instituted a plan under which low-income people, average citizens, could invest in a tax benefited savings plan.

These savings plans did not pay high interest, but they provided good tax benefits. Thus they became very popular. And because of the low interest rates they could be re-loaned to Japanese industry at very low rates of interest. This access to cheap credit, according to Drucker, helped to create the Japanese miracle.

What I have outlined here is a plan under which Social Security and other public services would be privatized, where people could invest their accounts and direct them like you direct an IRA. This effort could result in a source of cheap credit for the development of the black community. At the very least, if it's good enough for the Japanese, it's good enough for me.

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