

In Defense of Failure

BY STEPHEN SLIVINSKI

Failure gets a bad rap these days. Nobody prefers it to success, of course, but people tend to underestimate the importance of failure.

It's not hard to understand why. Failure isn't often fun to watch. When we look at a shuttered storefront, we can't help but feel bad for the newly unemployed workers. When we see a foreclosed house, we sympathize with the family that had to move. It's human nature. We may not like to accept the idea that failure is a necessary component of economic change.

But this often clouds our ability to envision a future when the capital that was poured into the failing business will be put to even better use. A future in which those unemployed workers instead become newly employed workers who build new avenues to prosperity. Or where the family that couldn't afford the larger house finds themselves in a more affordable one, which frees their income to pursue other investments and activities.

That might be small consolation to some. Perhaps it's even too close to the attitude of Voltaire's famous character, Dr. Pangloss, whose blind optimism limits him to seeing only the good in everything. After all, we should prefer a society in which contract law prohibits the sort of failure that is caused by fraudulent practices and duplicity. Luckily, that is indeed the world we inhabit. But maybe what motivates us to have an adverse reaction to failure generally might also be what helps markets work in the long run too — if we let it.

Take the recent attention paid to the mortgage markets. While the media's reporting on the subject seems to suggest that we're in a "crisis" of staggering proportions, most borrowers of all varieties are making their mortgage payments on time. The question hinges on what to do about those who are in danger of losing their homes to foreclosure. Such a question is best answered by the lenders and the borrowers themselves. They, after all, have the strongest incentives and best information with which to discover whether the best solution really is foreclosure or not.

We assume the same is true of other purchases and investments. We probably wouldn't hear reports of a car financing "crisis" if people bought SUVs and Hummers that they soon discovered they couldn't afford. In fact, there is such a thing as subprime car loans, yet media attention to them is scant. Why should the purchase of homes be treated differently?

The easy answer is that homes are different — it's where people live, not just an investment, and people spend much

more money on their homes than on their cars. Besides, someone bringing his car back to the dealership is not a dramatic news story; a person sleeping in his car because he lost his home is. Yet industry analysts frequently point out that foreclosure is often a more costly option to the lenders than simply working out a solution with the borrowers, like a new payment schedule. If that isn't feasible, however, it's hard to make a case to keep that capital locked up in that investment.

Markets do indeed have a way of aligning the incentives of two parties who are both self-interested and willing to enter into a contract or investment arrangement with one another. But not every investment pays off. Markets are, at

their core, a discovery process. Ask any successful entrepreneur how many times he failed before he found his big idea and you'll probably get many stories of heartbreak.

Yet, acknowledging that failure is an important component of eventual success is a hard argument to make when failure is staring you in the face. And it's often at this point that public policy decisions are made. Public policy should not impede the ability of a business or an investor to succeed.

But policy should also not impede or

encourage their failure either by protecting them from competition or insulating them from a bad decision. Unfortunately, the very understandable inclination of government to come to the aid of those against whom market trends have turned can also place the government in between those people and the consequences of their choices.

The same human instinct that naturally repels us from wanting to face failure helps explain other policies too. Trade barriers, for instance, are sometimes popular in part because supporters claim that they will avoid today the unsightly demise of yesterday's industries, including perhaps one in which you work.

The 19th century French journalist, Frederic Bastiat, wrote about the political impetus to focus on what is seen every day. But that doesn't make for good policy. He noted that good policy is instead based on recognizing what is *not* seen immediately with your own eyes.

Bad policies opt to remedy the discomfort of what is seen today at the expense of what is not seen immediately — a more efficient and vibrant economy of tomorrow. Impeding the learning and discovery process that results from our mistakes should be counted as one of those unseen costs too.

RF

Ask any successful entrepreneur how many times he failed before he found his big idea and you'll probably get many stories of heartbreak.