



## Needed: "Men With Chests"

Joseph Schumpeter, a late 19th-early 20th century economist, was the first economist to hail the pivotal role of the risk-taking entrepreneur. The entrepreneur (see yellow insert) is the individual who develops new products and/or production processes and, through a process Schumpeter called "creative destruction", destroys the existing economic order. Through such bold actions, real economic value is created, the kind of value that steadily raises our standard of living. It is also the source of economic profits that signal our industry to either mimic or to face the real prospect of destruction.

"...the function of entrepreneurs is to reform or revolutionize the pattern of production by exploiting an invention or, more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way, by opening up a new source of supply of materials or a new outlet for products, by reorganizing an industry and so on."

Joseph Schumpeter  
*Capitalism, Socialism & Democracy*  
1947

Schumpeter's prophecies, most of them written around the time of the depression, are interesting reading today. An ardent advocate of capitalism, Schumpeter nevertheless predicted that it would eventually be supplanted by socialism. Why? Schumpeter noted that economic growth with capitalism is painfully slow, only 2-3% per year for most developed economies. This, he said, was far too slow for "creative

destruction-impacted" workers and politicians (see green insert). There will always be cries for the government to "do something about it". And, as we know, they do!

Capitalism also tends to develop strong political opponents. Schumpeter called these opponents the "intellectual class" (see orange insert). Steady, albeit slow economic gains, and the power of compound interest raise our standard of living and this permits the emergence of an over-educated, under-employed class of people, people who are completely devoid of practical skills.

"Intellectuals are in fact people who wield the power of the spoken and the written word, and one of the touches that distinguishes them from other people who do the same is the absence of direct responsibility for practical affairs."

Schumpeter

And what is their reaction to their under-employment situation? "Smart people, like me, should be calling the shots, not this price system". Have you read the *Journal of Forestry* lately? Most importantly, Schumpeter also prophecies the demise of his central character, the entrepreneur. Why? Schumpeter predicts the emergence



PANELTECH  
RAIL LOG  
NETWORK

BUSINESS

GUIDELINES

- Learn all we can about what our customers need so we can do everything in our power to provide it
- Continuously reduce our costs of operation so we can pass cost savings on to our customers
- Safeguard the assets (logs) that our customers entrust us with
- While protecting genuinely proprietary information, serve as our customers' "eyes and ears" where we operate
- Reward loyalty with loyalty
- Grow the rail log network to improve network efficiencies, to enhance customer market power

"In order to identify himself with the capitalist system, the unemployed would have completely to forget his personal fate and the politician of today his personal ambition. ...rational recognition of the economic performance of capitalism and of the hopes it holds out for the future would require an almost impossible moral feat by the have-nots. That performance stands out only if we take a long-run view."

Schumpeter



of large, public companies and, with them, the emergence of bureaucracies that are “led” by people who, in his words, “aren’t prepared to die on the steps of their enterprise”. “...the modern businessman...is of the executive type. From the logic of his position he acquires something of the psychology of the salaried employee working in a bureaucratic organization. Whether a stockholder or not, his will to fight and to hold on is not and cannot be what it was with the man who knew ownership and its responsibilities in the fullblooded sense of these words. ..the modern corporation, although the product of the capitalist process, socializes the bourgeois mind; it relentlessly narrows the scope of capitalist motivation; not only that, it will eventually kill its roots.” (Schumpeter again)

We might add that the cornerstone of capitalism, self-interested behavior, also favors today’s bureaucratic, risk-adverse, salaried leader. The firm’s owners have clearly lost control of their compensation purse strings— far too many under-performing corporate leaders are paid far too much because their compensation has little relationship to their economic contribution. For their lieutenants and their lieutenants and their lieutenants, the financial incentives are equally clear— keep the boss (versus the customers and the investors) happy and you will also be very amply rewarded.

So, if the intellectuals and the victims of creative destruction and the politicians who prey upon them don’t weaken and eventually destroy capitalism, Schumpeter says the bureaucrats will! As Schumpeter reminded us, we have the best system of wealth creation that man has ever seen but, “...there

is inherent in the capitalist system a tendency toward self-destruction”. The self-interested, economically rational man will find their highest personal risk-adjusted rate of return in one of these large, bureaucratic enterprises— in the criticized and despised but materially rewarding world of “Dilbert”.

**“We make men without chests and expect of them virtue and enterprise. We laugh at honor and are shocked to find traitors in our midst. We castrate and then bid the geldings to be fruitful.”**

**C.S. Lewis**

Fredrick Weyerhaeuser, Sol Simpson, “Red” Emerson, Kenneth Ford— these are some of the “men with chests”, the “manly men” that built our industry. Will we find their replacements? Will a new entrepreneur, eschewing the “safe”, bureaucratic life, rekindle the kind of creative destruction that will transform our industry into an economic powerhouse again? Or, alternatively, will we ultimately sell off our timberlands and mill sites to more creative individuals, who find “higher” uses for them?

**“...manliness is its embrace of risk. Manly men, like heroes, live for risk. They do not seek protection from risk; they look for it for opportunity. They take charge confidently in circumstances when others hang back. They want honor more than gain; or, if they want gain, it is because large gains bring honor. And of course easy, regular gains are less honorable than those arising from unexpected, difficult situations—“tumarounds”. Facing risk is trebly individual: The situation is new, if not unique; the solution of manly responsibility cannot be counted on to occur; and the reward goes to a single person...bureaucracy is the true alternative to manliness.”**

**Prof. Harvey Mansfield (Harvard)  
*The American Enterprise*  
September 1, 2000**

Schumpeter’s critics note that socialism hasn’t triumphed as he predicted. Our economy has, if anything, recently raised its productivity again. Entrepreneurs like Bill Gates still pop up unexpectedly. In Schumpeter’s defense, if you look at today from his perspective way back in the 1920’s, he would likely challenge these assertions. He would likely say that what we have today sure looks like “socialism” to him.

In the 1920’s, government was about 3% of our economy. Today it approaches 20%. In the late 19th Century, railroads, the products of bold entrepreneurs, were the technological and economic marvel. Today only four major railroads survive and they are overseen by the federal government. We certainly have no shortage of “intellectuals” nor bureaucrats and we are, if anything, less tolerant of creative destruction.



## Rail Infrastructure Renewal

As we discussed in last month's newsletter, we are rapidly approaching a national surface transportation infrastructure crisis. As we also discussed, at least one solution has emerged for the highway system— pavement damage-adjusted congestion taxes.

Herbert Mohring, an economist at the University of Minnesota, has carefully crafted a congestion pricing scheme that would warm any efficiency-minded economists' heart—the system would be self-funding. Demand and new highway construction costs would, through the price system, ultimately determine the supply of new roads built by the private

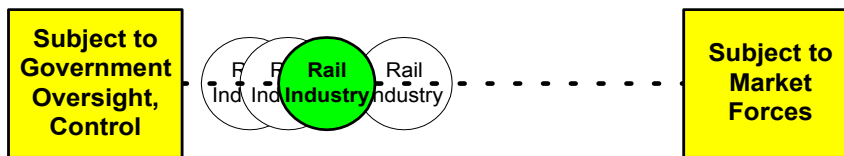
sector. He recommends disbursement of marketable congestion vouchers to the least-affluent automobile owners. Pollution taxes might also be called for.

So, what should we do to promote improved rail infrastructure? Schumpeter's answer would likely be "nothing"—these are independent, public corporations and, notwithstanding their potential to abuse their natural monopoly status, we should leave them to the vagaries of the marketplace. Those who advocate a more ambitious role for government would likely say, 'Isn't that the same viewpoint that led to our late 60's crisis in railroad bankruptcies, the 1970 government takeover of the Penn Central, the creation of Conrail, the result of which cost US taxpayers \$8 billion over the next decade?' A segment of like-minded people are currently lobbying for direct government funding of new rail infrastructure.

McKinsey (see, for instance, *The McKinsey Quarterly*, 2001, No. 4) have long recommended that previously-regulated, capital-intensive businesses like the railroads modularize their operations. The modules would include an infrastructure ownership division,

an infrastructure management division and a service delivery division.

### Where Should it be on the Continuum?



**Arguments for:**

1. A "National Plan" Needed
2. R/W Acquisition
3. Natural Monopolies ("Decreasing Cost" Industry)

**Arguments for:**

1. Efficiency
2. Creative Destruction
3. Impacts on National Extraction & Manufacturing Industries
4. Competition

These are, when you look closely, totally different businesses. An infrastructure ownership division could be run with a very small staff primarily focused on financial and regulatory (these are natural monopolies) risks. It would likely employ more financial

leverage to produce acceptable financial returns.

**"What the railroads lack is not opportunity, but some of the same managerial imaginativeness and audacity that made them great."**

**Theodore Levitt**  
**"Marketing Myopia"**  
*Harvard Business Review* (1960)

Infrastructure management and service delivery divisions would benefit from exposure to open market competition. This would include railcars and infrastructure maintenance, replacement and upgrading. Based on our personal experiences with the benefits of separating forest products

companies into forest asset and manufacturing divisions, we think McKinsey's advice is probably sound.

Before our government steps further into the funding and management of our few remaining railroads (shifts the "ball" in our exhibit further to the left), we believe we should again heed our old friend Schumpeter's prophecies. Our increased global interconnectedness makes the consequences of such intervention more broad spread and far less predictable.

## Recent Paneltech Developments

### LOGS

Rail service and rail cost problems continue to plague all of us. Rail tunnel fires and washouts are just the latest challenges. We have been reducing our presence in California but, just as we were about to completely close down our operations this past month, the governments became more serious in their efforts to spur log supply. A major project to handle logs from the BC Interior appears ready to take off. We are retrofitting more cars for Minnesota service. We even have interest in modifying our cars for long term log service in New Zealand! Roy will attend the "peak season" forum in Kansas City September 9th sponsored by the AAR. He will also speak on "rail" at the CINTRAFOR Conference in September.

### WEBS

The resin plant completion is a month late and we (like everyone else) are struggling with the cost and availability of energy-related feedstocks. Nevertheless, we should be up and operational right after Labor Day. With the aid of this new plant and our new lab, we are working on more innovative and environmentally-friendly products for the rapidly-growing resin-fiber composites industry.

### CONSULTING

We have a new consulting job related to the Southern California dead and dying timber situation.

*"It is not the critic who counts, nor the man who points how the strong man stumbled or where the doer of deeds could have done them better, The credit belongs to the man who is actually in the arena, whose face is marred by dust and sweat and blood; who strives valiantly...who knows the great enthusiasm of the great devotions, and spends himself in the worthy cause; who, at best, knows the triumph of high achievement; and who, at the worst, at least fails while daring greatly, so that his place shall never be with those cold and timid soles who know neither victory not defeat."*

*Teddy Roosevelt*

## "Logs" Seminar Reminder

In reminding you again of our October 13th seminar, we once again draw on the views of our old friend Joe Schumpeter, this time as he was quoted in a recent *Financial Times* article. What we try to do in our seminars is to expose log sellers, log buyers and logistics services providers to each other so they and, more importantly, their organizations can take advantage of what is called the "small world" phenomenon.

A researcher, Stanley Milgram, conducted a study in the 1960's. A "source" person in Nebraska was given a letter to deliver to a "target" person in Massachusetts. The source person was told only basic information about the target,

the source was then told to send the letter to someone he knew, on a first name basis. Anyone subsequently receiving the letter would be given the same instructions and this would continue until the target received the letter. Over many trials, the target received the letter in 5 or 6 steps. This is the source of the popular phrase, "only 6 degrees of separation".

Keys to fewer steps are unique people- the few folks who have an unusually large number of distant connections. Organizations that contain just one or two of these folks are far superior industry information and knowledge collectors. *Send in your registration form early to assure*

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*"Progress lies in new combinations of existing knowledge. That was the observation of Joseph Schumpeter, the Austrian economist, more than half a century ago. Since then it has become obvious that who meets whom- and in what circumstances- is critical to human advancement.."*

*Stephen Overell  
Financial Times  
June 21, 2004*