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Newt's Bain Opportunism Is Mitt's Opportunity

By Donald L. Luskin

Newt Gingrich's claim about Mitt Romney and Bain Capital -- that its business model was "figuring out clever legal ways to loot a company" -- is an egregious lie. Yet Mr. Gingrich is not stupid. He and the other Republican primary contenders who have echoed his attack have calculated that the only way to beat President Barack Obama, who uses the words "millionaires and billionaires" as insults, is to join him. It's unanimous, then -- capitalism is immoral.

At last, Mitt Romney finds himself with an issue that can define him, an issue about which the 2012 election can be a referendum. This is Mr. Romney's moment to distinguish himself by proudly making a moral case for free-market capitalism.

A merely pragmatic case for capitalism won't do. That's the phony expediency that Mr. Gingrich employs when he panders to pro-growth Republicans, saying "the whole purpose of investment is ... job creation." Capitalism has indeed proven to be excellent at creating jobs. But politicians -- from the bureaucrats who lent federal money to Solyndra, all the way to the outright socialists -- claim they can do that, too.

The enduring case for capitalism -- the moral case that Romney must make now -- is that it is the only economic system consistent with liberty.

Private equity -- the realm of capitalism in which Bain Capital operates -- is an expression of that liberty. There's nothing mysterious here. Private-equity firms are much like mutual funds that invest in stocks. But when a private-equity firm invests, it typically buys the entire company. Then the private-equity firm becomes actively involved in the management of the companies it owns.

Sometimes that means trying to turn around firms that have fallen on hard times. And if that doesn't work, private-equity firms can't just sell their shares and walk away. They have to take the responsibility for tough decisions: closing down factories and stores, eliminating jobs. A 28-minute film produced by a Gingrich-linked political action committee focuses on four such cases involving companies owned by Bain, replete with tearjerker interviews with laid-off employees intercut with distorted images of Mr. Romney looking vaguely satanic. The movie's implication is that any money Bain salvaged from these companies should have gone to these benighted workers.

The film is propaganda trash worthy of Michael Moore, not an aspiring presidential candidate who styles himself Reaganesque. For Mr. Gingrich to use this kind of irrationalism is a bid to replace the rule of law with the rule of emotions.

Under the rule of law, capitalists -- investors in real estate, factories, equipment, stocks, bonds or whole companies -- have the confidence to invest because they know exactly what their property rights will be under various scenarios of success or failure.

So investors can knowingly take big risks, first when they start or acquire a company, and then when they have to pay workers before there are any customers or any profits. They understand that if everything goes well, their investment will yield profits, and that someday they may be able to sell the business itself for a profit.

And they understand that if things go badly, and they have to shut down the business, all they'll end up with is whatever they can fire-sale its assets for. That could very well mean a loss. The workers whom they've employed all along will lose their jobs, but they were paid their salaries and benefits all along -- investors who rely on equity profits have no such guarantee.

This is what the word "equity" means, legally. It is the residual share of value left over once everyone else -- suppliers, lenders, the tax-man and employees -- are paid. An equity owner such as Bain is last in line to earn profits or salvage the remains if there is a failure. In compensation for that lowly status, equity owners get the lion's share of the upside if there is a big success.

The rules under today's politics are quite different. Consider the federal government's 2009 bailout of General Motors. GM's secured bondholders were contractually entitled to equity in the failing company, yet the president stripped them of their rights, giving their equity unfairly to the company's unions -- which had helped get that president elected.

This is the new order that Newt Gingrich is advocating when he attacks Mitt Romney and Bain: Equity should go to workers, not to the owners who made the risky up-front investments that created it in the first place. It's a vast new entitlement for labor -- one not embodied in law but imposed at the whim of the nation's chief law enforcement officer and now advocated by a man seeking that job.

Mr. Romney must stand up for the rule of law that underpins free-market capitalism. It can't guarantee a chicken in every pot -- and neither can any other system. But capitalism does guarantee a fair deal. Investors in businesses, and the employees who choose to work for those businesses, know exactly where they stand, and they have the liberty to invest or not invest, and to work or not work, accordingly.

Today the stagnant American economy is starving for investment while trillions of dollars sit on the sidelines. If Mitt Romney can restore the rule of law that free-market capitalism requires, those trillions will have the confidence to come back into play. Very likely, that would result in massive job creation. Surely it would result in liberty.

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