

MANAGEMENT VERSUS OWNERSHIP: THE ROAD-PRIVATIZATION DEBATE

LAURENT CARNIS

Roads are frequently cited as a public good even though economists have shown that privatizing the roads would solve some of the problems endemic to public roads, namely, high accident rates, congestion, and pollution (see Roth 1996, 1967; Block 1983, 1979, 1980). Economists have analyzed the problem of externalities and shown how the effects of free-rider behavior can be contained. The question of natural monopoly has been carefully examined, as well. Block (1979) has formulated something of a model showing how a private order would operate. The aim of this present article is to focus on some specific justifications that have been given for government intervention in the market for roads. It will be argued that “commercialization” is not the same as “privatization” and that a private road system must be built on clearly defined property rights.

What are the benefits that can be expected from privatization of the public roads network? It is difficult to answer without engaging in the methodological error of attempting to predict the results of the competitive market process, the very purpose of which is to discover the most suitable means of achieving ends. Economists make their most solid arguments when enunciating general considerations, based on a priori knowledge and general principles arrived at through means of deductive reasoning (Hoppe 1989, p. 1).

At the same time, history provides some illustrative instances of privately built and operated roads.¹ These examples demonstrate how private roads

LAURENT CARNIS is a Ph.D. candidate at the University of Reims Champagne-Ardenne. He would like to thank Guido Hülsmann for helpful comments and remarks and Jeff Tucker for helping to overcome the difficulties of the language.

¹Many works have demonstrated the historical viability of private roads including Klein (1996, 1990), Majewski, Baer and Klein (1993), Fielding and Klein (1993), Woolridge (1970), and Taylor (1953).

might operate in a market economy. The private roads network might consist of a number of different companies competing against each other for customers. Some roads would serve a purely complementary role. The existence of competition would be ensured, not only by the number of roads and road owners, but also from new firms gaining entry into a market uninhibited by legal barriers. Some new roads would be built in response to the desires of consumers, while others would disappear because they are no longer useful or profitable. This private market would discourage the overproduction of roads in specific areas and the underproduction of roads in others. Consumer demand and economic viability would drive and direct the level and type of investment, while profits and losses would reward some production and discourage others. Entrepreneurs, backed by investors from either privately or publicly held companies, would assume the risks and bear the consequences (Kirzner 1996).

There seems to be some confusion, however, in the relevant literature concerning the crucial distinction between full privatization and mere commercialization. Commercialization offers only partial solutions to the problems associated with public ownership. The pro-commercialization economists understand the importance of the market price and market mechanisms but misleadingly recommend it in the absence of property rights (Roth 1996, 1967; Friedman 1989; Vickrey 1963; Brownlee and Heller 1956). For instance, Roth (1996) proposes that the following principle should govern commercial pricing:

in a market economy, ways have to be found to enable all road costs to be paid for by those who use, or benefit from, roads, and that the amounts payable need not be determined by governments except when road users face monopolistic road suppliers. (p. 104)

The question remains how the price, in these cases, is to be determined, and by whom (Lipsman and Sandler 1996).

The problems associated with government determination of prices (Rothbard 1970) do not disappear when dealing with transportation issues. The general laws concerning price-fixing still apply. When the fixed price is too low, users receive a subsidy that corresponds to the difference between the set price and the market price; resources are underevaluated, and overutilization is the result. When the fixed price is too high, some drivers are obliged to spend more than would be necessary in an open market and, consequently, they decrease their level of consumption. It is certainly true that "it is essential that means of transport be properly priced so as to avoid overallocation or underallocation of resources to transport services as a whole, to particular forms of transport, or to particular segments of any given form" (Brownlee and Heller 1956, p. 249).

An arbitrary, administrative price provides only a partial answer to the problem of congestion.² Instead of reflecting the value judgments of market actors, the price expresses only the preferences of a single individual: the planner. Because public intervention prevents the emergence of market structures that reflect consumer value judgments, the correct market price cannot be established (Mises 1998). An arbitrarily determined price implies huge inefficiencies for producers and consumers and distortions in the allocation of resources.

The lack of attention given to problems of traffic congestion by economists suggests that the issue of “circulation” is generally regarded as an engineering management problem. By using the laws of physics, the engineer tries to regulate the flow of a river to produce electricity. To this end the engineer uses dams, weirs, and other tools. Similarly, in the field of traffic movement, the main problem is managing the flow of drivers. Drivers are considered as atoms, capable of being manipulated and without wills of their own. The variety of ways used to improve road safety is viewed from the same perspective. The wills of individuals disappear behind the experiences of engineers and the decisions of bureaucrats (Cahier des Autoroutes Françaises 1994; O.C.D.E. 1996; Wiel 1966, 1997).

We can find this type of analysis in Roth's work:

The proper price to charge is the amount equaling the cost of congestion *under the conditions prevailing after the imposition of the new price*. . . . It follows from this that it is not possible to determine the optimal road prices without a knowledge of the reaction of traffic to price variation. (Roth 1966, p. 41, emphasis in original)

The engineering perspective also appears in the work of Vickrey:

With street use controlled by pricing, however, it is impossible to insure that the level of congestion is kept down to the point at which buses will provide a satisfactory level of service, and rail rapid transit systems will be required only where a volume of traffic arises that will warrant their high cost on the basis of superior service and operating economies. (Vickrey 1963, p. 461)

Roth points out, correctly, that the price must not be fixed arbitrarily in order to determine a prescribed level of circulation, or in order to raise tax revenue (Roth 1967, p.41). But at the same time, Roth seems to share the perspective of an engineer, which is far from an entrepreneurial perspective. Roth denounces one pitfall but falls into another, writing that

²Obviously, we could charge a very high price so that only the drivers who could afford to pay would be very few. In that way, we could reduce the level of circulation to a desired level, creating at the same time a huge amount of costs.

[t]ime losses are probably the largest component of congestion costs, but congestion also results in increased fuel consumption and vehicle wear-and-tear, and in addition pollution. As a first approximation, all these costs may be assumed to be proportional to time losses, and they can be allowed for in the calculation shown above by appropriate increases in the value of time. It is however evident that the magnitude of congestion costs is critically dependent on the money values assigned to time savings. (Roth 1996, p. 71)

This formulation presupposes the ability to add subjective utility of different people and otherwise make interpersonal comparisons (Lipsman and Sandler 1996). However, it is impossible to make interpersonal comparisons of subjective utility (Rothbard 1956). Moreover, nothing can be asserted concerning the goals that government should follow. Government can seek a particular objective that may or may not have anything in common with the objective of individuals. For instance, decreasing the speed limit can reduce the consumption of oil (a governmental objective) but increase the time required by consumers.

Roth is aware of such limits and thus falls into a kind of skepticism:

[T]he calculation of congestion charges on the basis of delay costs requires assumptions to be made about the value of time, which is itself a highly contentious issue. . . . As to the preferred method of arriving at the optimal congestion charge, readers can take their choice. Those of us who support market economies are likely to prefer valuation methods based on the interactions of buyers and sellers in competitive markets to prices determined by governments on the basis of academic studies. (Roth 1996, p. 75)

Roth focuses his analysis on different methods of road pricing. He asserts (p. 103) that the charged price must cover the various types of costs he details and is thus inexorably led to repudiate his former attack on fixed prices:

How do commercial operators decide how much to charge for the goods or services they sell? Much has been written on this subject but the answer generally boils down to two principles: (1) To charge *no less than* the amounts required to meet the "direct" (or out-of-pocket) costs of providing the item in question, and (2) To charge *no more than* prices that maximize profits. (p. 61, emphasis in original)

The road user should pay a sum equal to the costs he imposes upon others. (p. 106)

On the contrary, the level of prices is determined by the interactions between customers and suppliers. The prices cover some expenses and some costs of production. The difference between costs and revenues rewards the competitive producers with a profit, while applying sanctions to the less competitive ones with losses (Kirzner 1996).

Roth's perspective leads to the belief that the government can regulate flow, not only by introducing price mechanisms on specific positioning of roads, but also by influencing the rules of the market:

Even under the commercial management of roads there would be important roles for governments. They should obviously have the last word on where new roads should be permitted (without, however, discriminating against privately provided roads) and on law enforcement. (Ibid., p. 38)

As a proponent of this type of commercialization and not privatization, Roth never deals with the issue of property rights, which would necessarily be violated in this scenario.

Finally, Roth sees the problem in terms of neoclassical economics. His thoughts about the case of monopoly and increasing returns are symptomatic. According to Roth's analysis, this kind of situation legitimizes the imposition of governmental hindrances:

If the owners enjoyed monopoly power, they could, if they were allowed to, charge more than the costs of providing the required facilities and collect more than the amounts required to keep them in the roads business. In market economies, the prices that may be charged by monopolists are generally regulated, to protect consumers. (p. 75)

It may therefore be concluded that the possibility of natural monopolies occurring in the supply of roads is not an objection to their commercialization, but rather a reason for encouraging commercialization and free entry as the best ways to protect the interests of roads users. (p. 166)

The idea of a natural monopoly is an imaginary construct to justify the establishment of legal monopolies in order to serve particular political interest (Lepage 1989). This theory has received a definitive refutation (Armentano 1999; Rothbard 1993). In the same vein, Roth defends an administrative choice concerning the management of roads networks. The government must manage the market process when one moves from the nirvana situation of a pure and perfect competition model. Governmental hindrances are also justified by the definition of norms with the respect to property rights (Roth 1996, p. 38).

Clearly, then, commercialization of the Rothian variety is not the same as privatization. Neither it is a priori true that commercialization represents an overall improvement over traditional public roads. The introduction of private methods into an essentially socialist structure leads to serious administrative and bureaucratic problems (Mises 1983). For instance, indirect methods of charging are indistinguishable from taxation in the form of surcharges on fuel and an axle-weight-distance tax. Roth's inability to propose a solution constitutes a problem in his major work dealing with commercialization.

Two approaches have been described in this section for calculating the appropriate charges for the use of congested roads. . . . Would calculations

based on these different approaches lead to the same result? If not, which is to be preferred? It is beyond the scope of this book, and the abilities of its author, to plumb the depths of this problem. (Roth 1996, p. 75)

The problem of where and how to invest in future roads is equally serious. Under commercialization, how can it be determined where the infrastructure should be built? Must it be built near other roads or further away? In a system where the prices are controlled and the competition hampered by government interventions, there is no true indicator, no real price. The mechanism of price loses its usefulness, and it becomes impossible to adopt the correct decision. Because there are only administrative prices, economic calculation becomes simply impossible. The impossibility of exchange makes impracticable and unrealizable the proper valuation of resources and hence their correct allocation (Mises 1988, p. 12).

The decision to invest or not to invest is taken by bureaucrats and politicians arbitrarily. Brownlee and Heller insist on the necessity of having criteria because, without them, investments are impossible (p. 237). However, the existence of criteria does not guarantee a correct allocation. A correct allocation becomes possible with the use of unhampered prices, as Mises showed clearly. To decree a criterion that can be called an “administrative price” is no help. It misinterprets what prices mean and constitutes an arbitrary decision, as the choice of the criterion is itself discretionary (Hoppe 1989, chap. 3).

In economic decisions, the choice of the criterion can imply perverse effects, creating larger distortions in other sectors of the economy. Activities tied to transport, the use of land, the development of cities, and property values are bound up with the initial allocation or misallocation.

Pricing of street use can in the long run have significant effects on the whole pattern development of urban communities and on property values. (Vickrey 1963, pp. 461-62)

In practice there are many alternative ways of financing; but no device can function quite as effectively and smoothly as a properly designed price structure in controlling use and providing a guide to the efficient deployment of capital. (p. 455)

These authors understand the role of price (in the abstract) and its effects, but they do not deal with what type of price is necessary to achieve the desired results. These authors often conflate administrative prices with market prices, even though administrative prices are a sure sign of government intervention and do not reflect the choices of users. These authors begin their reasoning in terms of equilibrium within a given network where no change occurs (Roth 1996, pp. 139-40). However, in a market economy, the network of roads must be thought as evolving, with new roads becoming necessary and others becoming useless over time. The neoclassical presentation expresses a confusion

between the role of a market as a process and its representation as equilibrium (Kirzner 1996). "The object of the 'right' price is to bring about a best level of road usage, i.e., the level at which the costs imposed by vehicles are first equal to the price they have to pay" (Roth 1966, p. 41). But what does the normal return mean? Roth (p. 138) introduces concepts without providing details about their significance. The capital and investment implications of road markets are not analyzed at all in his work.

The complexity and the evolution of the roads network creates new difficulties for governmental agencies and their ability to solve a wide variety of problems (accidents, pollution, traffic, etc.). The government, for example, must solve the problem of information. How can it gather all the knowledge necessary to properly allocate resources? What type of information do the engineers need and to what extent? By presenting the commercialization of roads as the solution to the management problems of the roads network, Roth presupposes that all of the relevant information is given, and he presupposes an ability to analyze it in order to fix the "correct price" for regulating traffic flows.³ But he never reveals where this information comes from. Consequently, Roth's analysis of the different methods of charging for using roads is unviable (Roth 1967, pp. 45-61; 1996, pp. 59-135). His model makes no room for entrepreneurs who must make judgments based on their expectations about future levels of prices, revenues, and costs, as happens in real-world markets (Mises 1988, p. 12).

In Roth's analysis, the costs are always costs of production, which in turn determine the level of prices. The absence of consumers and entrepreneurs is symptomatic of Roth's analysis, and, indeed, their presence is unnecessary when employing an additive conception of costs. Yet, for reasons of economic calculation and information, an arbitrary administrative price cannot solve the problem. It can only focus on a part of the dilemma.⁴ The Rothian system is also a static one. The actual market must be thought of in terms of dynamics and perpetual movement. Some entrepreneurs invest and discover new opportunities of profit and enter the market to supply what the consumers desire (Block 1980; Kirzner 1996; Mises 1998). If they are not competitive, they are displaced by others who supply a better product.

To build a roads system, an administrative price mechanism—commercialization—may yield some solutions to the problems of public roads (congestion, overutilization, etc.), but it gives rise to other problems that cannot be

³This level of traffic must be a tradeoff between a level of pollution, risk of accidents, and loss time of driving.

⁴Obviously, we could assign a very high price so that few drivers would be willing to drive. In that way, we could reduce the level of circulation, creating, however, huge costs in other ways.

solved by central planners. To solve fully the problems associated with public roads, we must envision a system with no arbitrary hindrances and with clearly defined and exchangeable property rights in the roads network and land. If the roads network is to be subject to market discipline, it must be desocialized, not merely commercialized.

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