Property Rights and Pricing

by Richard W. Rahn

Many problems exist because the activity is mispriced and/or the key decision makers lack the proper incentives. Argentina is going through another financial crisis which occurs almost like clockwork every few years.

The country spends more than it receives in taxes; and eventually the bondholders refuse to lend more, and rational people try to get rid of the local currency and buy U.S. dollars or gold, or something else, to protect themselves. To prevent a general economic collapse, the International Monetary Fund (IMF) rushes in to save the day with one of its restructuring programs.

If the restructuring programs were properly designed and IMF loans were withheld until the restructuring was completed, Argentina, Greece or whatever country would not have to keep coming back for more. The problem is the IMF (or World Bank, or whatever international development bank) invariably gives in to political pressure to provide funds before full performance.

If the IMF were a private, profit-making institution, the officers and staff would likely be much more diligent in evaluating risk if their pay and pensions were directly tied to profitability and if they knew that no government was going to bail them out.

If a private bank has reason to think that a government views them as "too big to fail," they also tend to take excessive risks. Property rights are a powerful incentive to act responsibly — particularly when those involved realize that they can lose of all their property, including at least some portion of their pensions, if they make bad decisions.

Americans and many others often complain about poor infrastructure. Even before the American Revolution, Americans were unhappy with the lack of roads, bridges, etc. But back then, some formed private companies to build toll roads, bridges, canals, etc. The term "pike" on the back of a name for a road had its origin in early, and most often private, toll roads. The pike was a pole that blocked the use of the road. It was mounted on a wooden structure that could turn; hence, the word "turnpike."

The "Georgetown Pike" in Northern Virginia was one of the earliest private toll roads in the United States. It was taken over by the government a couple of hundred years ago and now is a normal two-lane road except for being designated as a "scenic bypass" by the state, which means that it cannot be enlarged or otherwise substantially altered.

The problem is that the surrounding population has grown and the "pike" has long traffic delays during rush hours. The solution would be to institute a variable rate toll, based on the time of day, to smooth out traffic flow, as is being done on some major new roads nearby. The pole or pike with a toll booth would no longer be necessary, just an electronic reader.

This technology is already in widespread use and could be employed to eliminate or substantially reduce most traffic backups — thus saving time and reducing pollution from idling auto engines. It is fair because drivers would decide how much the use of a road at a given time was worth to them.

Most infrastructure needs could be solved if private companies were given concessions for building and operating the structure or facility with variable rate pricing for some number of decades. This is true of roads, bridges, airports, seaports, tunnels, etc. Most major public infrastructure projects end up having major cost overruns borne by the taxpayers, rather than the politicians responsible. Why not shift the cost and risk to the private sector?

The railroad tunnel between New Jersey and New York City under the Hudson River was built more than a century ago by the Pennsylvania Railroad company. There is a need for a new tunnel and the politicians are demanding the taxpayers underwrite the cost. Why not give a private concession to build and operate it so that the actual users pay the cost?

Politicians in both large and small countries tend to think only of the short term and usually have little notion of cost-benefit and how to control costs. For example, the Cayman Islands have a vibrant tourist and financial industry which has brought them great prosperity — as well as a very attractive 21st-century private physical infrastructure. They are in the process of upgrading and enlarging their airport and seaport.

Unfortunately, major mistakes are being made, basically, because the politicians think that the government should pay for, own and operate these facilities. The under-construction and planned facilities will be insufficient and outdated on almost the day they are completed, and not well managed because of the wrong incentives — and the taxpayers will be saddled with the cost overruns.

The taxpayers need not be on the hook for any of the costs. Both the airport and seaport are largely used by foreign tourists and business people. Both of these facilities should be and could be financed by user fees, advertisers and concessionaires.

George Washington was chairman of a canal company in Virginia in the late 1700s — that went bust. Washington and his fellow investors ate the loss rather than taxpayers. These were honorable men who went on to make many successful investments that built America.

Richard W. Rahn is chairman of Improbable Success Productions and on the board of the American Council for Capital Formation

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