

**PRIVATE ROADS,
COMPETITION,
AUTOMOBILE INSURANCE
AND PRICE CONTROLS**

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Abstract

In the view of most economists, highways and streets are "public goods," not amenable to ordinary market competition. The present papers argues, to the contrary, that these thoroughfares are conducive to competitiveness, and then applies these insights to automobile insurance and price controls.

Introduction

Under present institutional arrangements, there is a modicum of competition which takes place with regard to our nation's roads. Sad to say, however, such competitiveness is superficial, very limited and only indirectly related to these transportation corridors. For example, advertisers compete with one another in terms of highway billboards; insurance companies vie with each other over automobile coverage; roadside restaurants, gift shops, etc., each attempt to wrest market share from their counterparts.

But in terms of knock-down, drag-out competition, of the sort which earmarks, for example, the industries which provide us with ships and sealing wax, computers, automobiles, books and movies, there is none. There could hardly be any, since for the most part roads, highways, streets and other vehicular thoroughfares are all owned and managed by different governmental jurisdictions¹. None of them can earn profits

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from wise managerial decision making, nor suffer losses and risk bankruptcy from the lack of same; as with all activities performed in the public sector, such competition cannot, but the very nature of the enterprise, take place.

Why is this an unfortunate state of affairs? Because market competition tends to bring about more economic efficiency than governmental bureaucratic control. *Ceterus paribus*, the weeding out of the inefficient which occurs under free enterprise tends to ensure a higher quality product at a lower price than that which emanates from the public sector which does not benefit from this process. States one anonymous referee in this context, "privatization of roads could make a society more competitive by allowing more efficient use of resources, including spending on insurance" and much much more. For example, Block (1979, 1983a, 1996) give reasons to believe that competition between private highway owners would reduce the motor vehicle death rate, surely evidence of an inefficient use of resources, and Block (1980) demonstrates that such private arrangements will tend to decrease road congestion (more incentive toward peak load pricing), which is certainly another economic misallocation.

It must be faced at the outset, however, that this scenario will strike many as unlikely in the extreme, not to say bizarre. Are not highways the sorts of things that must, by the very nature of things, be assigned to the public sector? How could private streets overcome the free rider problem? Are not roads quintessential public goods? How could private firms surmount the difficulties associated with non excludability? What about monopoly?

We must object to the claim that there is something intrinsic about roads that renders it

necessary for them to be part of the "public" sector. The original highways, turnpike roads, were invariably private concerns; the theoretical arguments opposing vehicular thoroughfare privatization are all invalid.² Even nowadays, there are miles of private "streets" which function exceedingly well, despite the fact that most commentators have not appreciated that they accommodate automobile traffic³. Nor is there any theoretical reason why such a state of affairs *could* not prevail for the entire vehicular transportation network of the U.S. We are accustomed to regarding long, thin entities such as highways as impossible to privatize. But railroads, which are equally "long and thin" have for many decades been built, owned and managed by profit making firms⁴. Access need not be limited by use of antiquated coin toll booths⁵. The universal product codes which keep track of groceries could easily be applied to automobiles; even our "horse and buggy" highway authorities are now — at long last — in the process of introducing such automation⁶. Nor need we fear that a private street owner would not allow automobile access, or would charge unreasonably high "monopoly" prices; our experience with the typical for profit railway line is that it "tried its best to induce immigration and economic development in its area in order to increase its profits, land values and value of its capital; and each hastened to do so, lest people and markets leave their areas and move to the ports, cities, and lands served by competing railroads. The same principle would be at work if all streets and roads were private as well" (Rothbard, 1978, p. 204).

Such irresponsible behavior would be impossible in any case since "everyone, in purchasing homes or street service in a libertarian society, would make sure that the

purchase or lease contract provides full access... With this sort of 'easement' provided in advance by contract, no such sudden blockade would be allowed, since it would be an invasion of the property right of the landowner" (Rothbard, 1978, p. 204).

Having introduced the concept of street, road and highway privatization, let us now utilize it to assess an analysis of a related issue: automobile insurance rates.

Automobile Insurance Rates

Smith and Wright (1992, hereafter SW) set themselves two main tasks. The first is an explicit one. As the title of their paper indicates, it is to explain just why Philadelphians pay higher automobile insurance rates than do people of other cities in the U.S. The second task is an implicit one, or at least it is not so fully explicit. This is to add to the already voluminous literature which seeks to justify price controls on the basis of economic efficiency. The remainder of this paper will confine itself solely to their second point; it will show that although hoary with tradition, this rather clever attempt to justify price controls — on presumably value free grounds — succeeds no more than any other.

What are the arguments of SW? Simply stated, they maintain that there is a sub-optimal equilibrium (to which Philadelphia and several other cities have sunk), where automobile insurance rates are so high that an excessive number of drivers elect not to avail themselves of this protection. This, in turn, leads to excessively high rates for the law abiders, which deter the non-insurers in the first place. And why is this? It is due to the lack of coverage for accidents of the non-insured which spills over negatively to all and sundry.

In the words of SW: "When an uninsured or underinsured —driver causes an accident, the damaged party will be forced to collect from his own policy if the at-fault party does not have sufficient resources to compensate his victim. Hence, when there are significant numbers of uninsured or underinsured low-wealth drivers, insurance companies have to charge higher premiums in order to earn a given rate of return, and these higher premiums may be enough to discourage some drivers from purchasing insurance" (SW, 1992, 759).

The contention of SW is that society needs to break through this vicious cycle. How can this be done? Their public policy recommendation is that government should control auto insurance rates, bringing them down to the level where even the law breakers, under the present system of "market failure" (SW, 1992, 771) will choose to insure. Then, all can both enjoy the lower rates, and the better driving conditions that a reduction of lawlessness will bring about.

To be fair to SW, they do not claim that such price controls will necessarily bring us to this nirvana of optimal equilibria; they continually stress only that numerous equilibria "could" or "might" exist; and that even if they do, it is only "possible" that controls (on price, entry, coverage, no-fault, assigned risk, etc.) can reach an optimal situation. They are fully cognizant of the California situation, where ceilings on rates seem to have led to the withdrawal of insurance firms, not to the attainment of any optimal equilibria. Nevertheless, despite their cautious mien, there are grave problems with this analysis, to which we now turn.

1. SW see "market failure" as the underlying cause of the problem, and government control as the solution. They state

"Concerning efficiency in laissez-faire, our model demonstrates the possibility of market failure in the market for automobile insurance" (SW, 1992, 770).... "In this paper, we have demonstrated the possibility of market failure in the automobile insurance market...." (SW, 1992, 771).

But how can they coherently talk of a failure of markets, or, even more extremely, of laissez-faire capitalism, in the context of state owned and managed roads and streets? Their charge is almost akin to the claim that our welfare system, or social security, represents a market failure. This is clearly *government* failure, not *market* failure.

The plain fact of the matter is that the U.S. now suffers under a Sovietized highway system. Although here and there can be found a private street or bridge, the overwhelming majority of our country's vehicular transportation arteries are under state authority⁷. So if there is any failure in this sector of the economy, it would be amazing if it were due to "markets." To characterize the present state of affairs as one of "laissez faire" is very wide of the mark indeed.

2. SW seem to have taken the advice of Coase (1937, 1960, 1992)⁸ with regard to the importance of institutions⁹. Their footnote 5, for example, constitutes a very detailed examination of a rather minute institutional detail. But this concern is more apparent than real, as indicated by their failure to take into account the statist institutional arrangements which now earmark the nation's highway system.

They note that "a few cities like Philadelphia and Miami have nearly 40% of their drivers uninsured" (SW, 1992, 760). Under present institutional arrangements there is of course no automatic feedback mechanism to penalize those managers who allowed the situation to get so far out of hand. Under a competitive street industry, of course, there is little doubt that firms which stood by idly under such a state of affairs would long ago have gone bankrupt, and their places taken by those with more competence¹⁰.

3. The SW analysis fails to take cognizance of the social functions of a freely functioning insurance industry. By discriminating amongst customers, and charging more for those more likely to file for claims (e.g., people who smoke, drive carelessly — or whose age, sex, race or other characteristics are correlated with dangerous actions) they tend to reduce the incidence of such anti-social behavior. In the present context the uninsured drivers are more likely to create accidents than the insured; if they were effectively denied access to roads — as they would be under highway *laissez faire* — this would undoubtedly reduce traffic fatalities.

SW propose a plethora of policies designed to handicap the insurance industry, but it is difficult to see how they can improve social welfare given that they have not incorporated the positive contribution of insurance firms to this end.

4. SW discuss sub-optimal equilibria in terms of high premiums deterring poor people from insuring, while lower ones might encourage them in this behavior, to the general benefit of all concerned. Let us, having criticized this proposal, offer an alternative.

Stipulate it as a given that we must regulate automobile insurance rates; perhaps, then, it would be better to require *minimum* rates, not the maximum ones offered by SW. That is, instead of price ceilings, lowering payments, let us suggest for argument's sake price floors, raising them. How could this be justified, using the methodology for which we must thank SW?

Simple. If insurance companies were required to *raise* their rates, even fewer people would insure. Non-insurance rates of 40% which are now the exception would instead become the norm. Perhaps the minimum. In many cities we would "achieve" non compliance rates of 80%, 90% and even 95+%. This, then would render present driving conditions an utter shambles, given the SW analysis. But it would also have the very salutary effect of so predisposing the electorate against present socialized road management that privatization might actually occur. If so, perhaps, the interim "disturbed" era might well have been worth it.

Now I am not advocating any such scenario. But if this *reductio ad absurdum* for a price floor is no less theoretically viable¹¹ than the SW claims in behalf of a price ceiling, it tends further to dispel any attractiveness of the latter.

An Objection

The public policy recommendations of this paper are very radical, particularly in the context of present day political economy. The solution offered here is one of total *laissez faire* capitalism: the government would have absolutely no role to play as regards traffic thoroughfares, apart from protection of private property and defense of contract. Just as radical privatizers of education call for

separation of school and state (Richman, 1994), radical privatizers of the post office call for the separation of mail and state (Hudgins, 1996), and radical privatizers of welfare call for a completely voluntary system of charity with no state involvement at all (Rothbard, 1973, 142-170), the present paper recommends the total separation of highway, street, road and sidewalk from the government. In these other cases, however controversial, it is at least crystal clear precisely what is being advocated. Not so, perhaps, in the present case. Consider in this regard the following objection: "At the basis of this paper is a concept of privatization of roads being a market driven solution to the insurance dilemma facing cities such as Philadelphia. Most of the specific analysis, however, deals with the issue of privatization of security on these roads. Who builds and owns the roads doesn't have anything to do with insurance. Who is responsible for allowing individual drivers on the roads is. The problem is that uninsured drivers are 'allowed' on the roads by a security force (police) that cannot stop them.... The author seems to be saying that privatizing the enforcement duties will solve the problem. This is very different from the road privatization issue in general (though is obviously a related one) and has virtually nothing to do with the comparison to land collectivization"¹².

There are several difficulties here.

1. The public policy prescription being offered here is by no means confined to "privatization of security on these roads." The solution does indeed involve this, but it involves much more as well; that is, privatization is not at all confined to highway policing. In order to solve the external diseconomy problem of underinsured drivers,

the whole ball of wax must be privatized. Security, yes, but also, the entire operation, including purchasing rights of way (there could be no such thing as eminent domain under laissez faire capitalism), pouring the concrete, setting up the rules of the road, charging for road usage, filling the potholes, etc. It is as if I were advocating the total privatization of the U.S. Post Office, or a Soviet farm or factory, and this were interpreted as promoting only the private policing of these facilities.

2. While it is undoubtedly true that "who builds and owns the roads doesn't have anything to do with insurance," this need not at all be the case under a regime of economic freedom. There is simply no reason to believe that a private insurance industry would have no role to play in an era of private road ownership. How might this work? One possibility is for an amalgamation of a road owning corporation and an insurance firm. This is something which right now might be considered a conglomerate merger¹³, but might one day deemed vertical. That is because, second possibility, the two can work together, as firms in different levels of production, toward the creation of the good, safe driving. It is often difficult to anticipate precisely how a newly privatized industry would function; but in one scenario, the road owning firm would base its user charges on the safety category a driver were placed into by an insurance company. For example, if a motorist never had an accident in 20 years, and were charged a low rate by his insurance company, the highway corporation might charge him a lower rate.

3. While there may be a problem where uninsured drivers are "allowed" on the roads by a security force (police) that cannot stop them in some proposals, the present case is not one of them. Here, presumably, the highway owner

would hire its own police force¹⁴, and these officers would be fully empowered to refuse entry to any obstreperous or dangerous driver.

4. It is not true that road privatization "has virtually nothing to do with ... land collectivization." On the contrary, they are intimately connected. For under present institutional arrangements of "road socialism" (Block, 1996), all of the land on which roads, streets, sidewalks, etc., are built is indeed collectivized. During the heyday of communism in Russia, conservative commentators criticized with great glee the long queues in that country waiting to purchase groceries. But is this really very different from motorists waiting on congested highways such as the Long Island "Expressway" to consume further highway transportation? Our system of providing vehicular transit arteries is every bit as Sovietized as the Stalinist grocery "industry." Both are in dire need of de-collectivization.

Conclusion

There can be political competition in places like North Vietnam and Cuba, but in the absence of free enterprise there can be no economic competition. This is why privatization and competition are inseparably linked. Without the former, the latter is logically impossible¹⁵. But this applies to roads and highways no less than to cabbages, chalk, and cheese. It is perhaps the contribution of this paper to show that economic competition on the roadways cannot take place in the absence of privatization, and that it is this lack, not any "market failure," which is responsible for the plight afflicting cities such as Philadelphia.

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Autobiography

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