Readings of particular interest

Why Private Transit Works

Free Enterprise Urban Transportation by Gabriel Roth and George G. Wynne (Transaction Books, 1982), 72 pp.

In this book, Gabriel Roth and George Wynne identify some of the reasons why private transit systems are thriving in various cities around the world. The book is part of the Council for International Urban Liaison's series "Learning from Abroad." Wynne is associated with the council; Roth is an economist with the World Bank's Economic Development Institute.

Some of the most successful private transit services originally developed illegally, in the form of "gypsy" vehicles. In Hong Kong, there has been a thriving illegal minibus system since 1933, when bus companies were granted exclusive franchises to serve the busiest sections of the colony. The black-market buses helped fill the void during public transit strikes in 1967, but afterwards police resumed efforts to suppress them. In 1969 the colony's government gave up and licensed them, and by 1976 they were carrying one-third of all public transport trips.

Even when private buses are legal, they are often discouraged by local authorities who accuse them of clogging the streets, taking traffic away from conventional bus lines, and concentrating on the most lucrative routes. In Hong Kong, Manila, and Kuala Lumpur (the capital of Malaysia), city officials have frozen the number of minibuses and discourage them from using main roads. Overcrowding is a frequent result: the Kuala Lumpur minibuses run at 125 percent of capacity during the evening rush hour.

The authors defend private systems against all three criticisms. Because private buses are usually smaller and more maneuverable than public buses, they do not necessarily worsen congestion. That they take customers away from municipal lines is no argument against them either, the authors say: indeed, it is likely to remedy the existing state of "cross-subsidization." In any case, private operators often serve slums and outlying areas neglected by municipal and franchise lines.

In some cities, a "route association" serves to coordinate the private buses operating on a particular route. In Buenos Aires, for example, each route association is a sort of cooperative of independent vehicle owners and serves as the formal employer of the drivers. Members are responsible for the upkeep of their own vehicles. The route associations maintain strict timetables, since "a bus running late tends to pick up more than its 'fair share' of passengers, at the expense of the following bus." In Calcutta the associations levy fines to discourage lateness; sometimes the fines are paid directly to the owner of the following bus, in an amount proportioned to the length of the delay.

Buenos Aires is "the only known example of a major city in which bus services were 'demunicipalized' and returned to the private sector," the authors write, and "the results are generally considered to have been a spectacular success." The "colectivos," as they are called, developed in the 1920s as shared taxis. In 1936 and 1951 the city government established by stages a complete municipal transit monopoly, but by 1959 this system was losing $1.2 million annually. Three years later it was dissolved and its services turned over to private operators. Now there are a total of 13,000 private vehicles that carry 75 percent of all public transport trips. Over the years the size of the private vehicles has grown gradually to twenty-three seats.

In Calcutta, as in Hong Kong, private buses were legalized in the wake of transit strikes. Today they account for about two-thirds of all Calcutta bus trips. The private operators are not subsidized, while the public bus enterprise, which runs on similar routes and charges the

same fares, receives about $1 million a month from the desperately poor city government.

Municipal transit operators tend to favor very large buses, which economize on expensive labor; independent operators typically prefer minibuses. When private operators took over the Buenos Aires transit operation, for example, they replaced many full-sized buses with twenty-three-seaters. Small buses appear to cost less per passenger than large; in San Juan, Puerto Rico, a seventeen-seat bus costs $17,000, while a fifty-seat full-sized bus $140,000. (Incidentally, the diseconomies of scale do not stop there, the authors say: a rail car seating over a hundred can easily cost $1 million.) One reason for the cost gap is that smaller vehicles are mass-produced while the larger ones tend to be custom-built.

Perhaps more important, systems using large buses force passengers to wait longer for a ride—which is one of the major reasons why riders switch to independent vehicles when given a choice. In monopoly or monopoly-franchise operations, the authors say, "planner sovereignty" tends to win out over "consumer sovereignty."

Private operators gain another big cost advantage from the intensity with which they utilize their equipment. In Kuala Lumpur, 400 private sixteen-seat minibuses carried more passenger-miles in 1978 than 600 fifty-eight-seat conventional buses. The average Buenos Aires private microbus employs three persons to carry 1.3 to 1.6 million passenger-miles per year, or just under 500,000 per employee per year. In Calcutta, to move to an opposite extreme of productivity, only about half the municipally owned buses are operating at any one time; when a bus breaks down, officials must go through cumbersome channels to obtain spare parts. The private operators buy spare parts on the black market when necessary.

The private lines also keep labor costs down. Studies in industrialized countries have found pay rates to be lower on private bus lines than on public, the difference amounting to 10 to 15 percent in the United Kingdom and 10 percent in Australia. There are fewer rigid work rules, so that the same employees may combine driving at peak periods with maintenance chores at other times. On private operations family members help out with many tasks, and record-keeping is held to a minimum. By comparison, overstaffing is endemic in the municipal systems: Calcutta employed thirty workers per bus in 1980. Even this was a lower ratio than the 58-to-1 for the municipal system in Kinshasa, Zaire. Since half the municipal buses in each city are out at any one time, the real ratios are more like 60-to-1 and 116-to-1 respectively. In Australia, by contrast, the ratio of employees to buses is typically 1.0–1.5 to 1 for private operators and 2.0–2.5 to 1 for public operators. In Calcutta, incidentally, private bus crews are paid a share of the fares they collect; one result is that fare evasion is near zero, compared with an estimated 25 percent on the municipal lines.

The cost savings may carry over to the industrialized world as well. The authors report a 1980 study by the United Kingdom Transport and Road Research Laboratory which found that private buses in Britain charged 25 percent less than public buses on similar rural and interurban routes. Their advantage consisted in lower unit costs, rather than, for example, higher load factors. A similar study of three Australian states found that private buses cost only from one-half to two-thirds as much to operate as public buses.

Guidelines to Nowhere

Wage-Price Standards and Economic Policy by Jack A. Meyer (American Enterprise Institute, 1982), 80 pp.

In this work Jack A. Meyer assesses the wage-price policies of the Council on Wage and Price Stability during its six-year life from 1974 to 1980, especially the voluntary wage-price standards launched by the Carter administration in October 1978. "There is no solid evidence," he concludes, "that [the] guidelines had any effect on the pace of wage and price inflation." Meyer is a resident fellow in economics at AEI and was formerly assistant director for wage-price monitoring at CWPS.

The 1978 Carter rules set a 7 percent ceiling for annual pay increases in private industry (counting fringe benefits) and a ceiling for a company's average price increase of at least half a percentage point below the increase in a 1976–77 base period. The seeming simplicity of

these rules did not last long, however. Soon CWPS was churning out detailed guidance for every circumstance, complete with exceptions and appeals processes.

CWPS's decision to alter the standards in particular cases led it into a process of negotiation with firms and unions that, Meyer contends, compromised the goals of the program and generated inequities among different categories of workers and firms. In the bargaining over a new truckers' contract in 1979, for example, "the government went well over its own guidelines in order to obtain the appearance of Teamster compliance (therefore avoiding a showdown or a major setback to the program). . . . The union was negotiating with the federal government while employers were third-party observers."

In the twelve months before the guideline program began, consumer prices advanced by 8.3 percent. This rate rose to 12.1 in the program's first year and 12.7 percent in its second year. Wage rate inflation, however, did not accelerate as fast: unit labor costs rose 8.2 percent in the year before controls, 11.1 percent in the first year, and 10.3 percent in the second. Inflation in hourly earnings stayed practically level, rising only from 8.4 to 9.0 percent—which has led some observers to suggest that the guidelines had some success on the wage side.

Meyer uses several econometric methods to assess these results, including some methods used by CWPS itself. He finds "claims of a program impact on wages to be largely illusory. Estimates of the program's impact on wages are highly sensitive to the exact specification of a wage equation, as well as to the precise time studied." Labor productivity and business profits dropped over the period, which would normally decelerate wage gains. Nor would it be easy to judge the program's success even if it had clearly managed to slow down wage inflation, he says, since its costs in administrative and compliance expense, and in scarcer and shoddier goods and services, might prove unacceptable. Furthermore, in the author's view, incomes policies sometimes seem to achieve temporary but not lasting progress in reducing inflation: the inflation rate surged after the standards ended, similar to the "catch-up" effect observed after the end of other wage-price control programs in this country and elsewhere.

The author concludes that "a small, independent agency [like CWPS] conducting selected reviews of collective bargaining, individual price behavior, and government regulation would have been a low-cost worthwhile unit to keep intact." The ultimate solution to inflation, however, must depend on "the steady withdrawal of the excessive government stimulus to the economy in a credible fashion."

Should Investors Share the Wealth?

"Corporate Control Transactions" by Frank H. Easterbrook and Daniel R. Fischel, in *Yale Law Journal*, vol. 91, no. 4 (March 1982), pp. 698–737.

Many corporate acquisitions, such as Du Pont's recent purchase of Conoco, have been accomplished in two stages. First the acquirer offers to buy a controlling stake in the target firm at a price well above the prevailing stock market quote. Then, after securing 51 percent of the stock, the acquirer merges the two firms. The terms of the merger typically require the remaining minority shareholders to sell out for a price below the original offer, although still above the preexisting market price of the stock. Other types of corporate transactions also affect minority and majority holders differently. Among them are sales of controlling blocks of stock at prices that reflect a "control premium," stock repurchases by which a publicly held firm "goes private," and a whole range of dealings between holding companies and their partially owned subsidiaries. All of these practices are subsumed under the general heading of "corporate control transactions."

Transfers in corporate control can lead to real, not just paper, economic gains (which is why the buyer can afford to pay a premium in the cases above). Mergers capitalize on economies of scale, "synergy," and so forth. Control transactions can also replace bad managements, increase a firm's legal freedom of action (in the case of newly consolidated subsidiaries), lower (or eliminate) the expense of communicating with small shareholders, and give managements an ownership stake in their firms' performance.

Some critics have charged, however, that such transactions are unfair and should be re-

stricted by law when the gains they produce are not shared equally among majority and minority stockholders. Frank Easterbrook of the University of Chicago Law School and Daniel Fischel of Northwestern University Law School examine these critics' arguments in this paper, and conclude that so long as no one is made worse off by control transactions, there is no legal and no economic reason to split their gains, equally or otherwise, among all stockholders. (Losses are no problem, they say, if they are absorbed by the buyer, and in any event studies have shown that the "overwhelming majority of control transactions" do lead to gains.) Thus they find two-tier tender offers unobjectionable so long as bidders pay at least the original market price for the remaining shares after they obtain control; they find sales of controlling blocks of stock unobjectionable so long as the sales do not cause a decline in the value of minority shareholdings, and so on—all of which opinions, they say, comport with the prevailing (but much-maligned) rules of corporate law.

The authors seek to elucidate the rationale for the prevailing rules by offering a general view of the nature and role of fiduciary duties —in this case, the duties that a management installed by majority shareholders has to look out for the interests of shareholders in general. Some such residual, implied legal rules are needed, if only to govern how managers should act in unforeseen circumstances, since formal contracts between investors and managers cannot cover all contingencies. Although these fiduciary principles should be elastic, the authors say, they must be designed single-mindedly to fulfill the interest of investors in obtaining the highest returns possible.

Critics of the current state of the law hold that one part of fiduciary responsibility should consist of an obligation to treat all investors equally when making, for example, the decision to surrender control of the firm. But, write Easterbrook and Fischel, to "say that fiduciary principles require equal (or even fair) treatment is to beg the central question—whether investors would contract for equal or even roughly equal treatment." Allowing "unequal" as well as "equal" transactions may be the way to maximize the number of productive deals, and investors will fare best overall if every value-increasing transaction is allowed to occur, regardless of how its gains are distributed among beneficiaries. Thus the typical investor, if allowed to contract in advance, would specify whichever fiduciary principle would allow the most such transactions to take place.

That principle, Easterbrook and Fischel argue, is the one that best permits the active parties who create gains—for example, bidders in tender offers—to keep as large a share of them as the process of negotiation permits. Those active parties are the ones who must pay the costs of the deal, such as the cost of printing documents and hiring accountants and lawyers. Letting them negotiate for as much of the real gains as they can get encourages them to proceed with any deal whose gains outweigh its costs. A sharing rule, by contrast, allocates gains to passive parties—which reduces the likelihood that the active parties will produce any gains to share. For example, "freezing out" minority shareholders prevents them from getting a "free ride" on the benefits of the merger and thus captures more of the benefits of the merger for its originators.

It may be objected that investors are sufficiently risk-averse not to want to hazard an unequal distribution even of greater benefits. Easterbrook and Fischel have two replies. First, any investor may buy any publicly held security, and control transactions are so numerous that the benefits are spread quite widely in any case. Second, risk-averse investors can easily lower their uncertainty simply by diversifying their portfolios.

Worker Safety and the Coal Market

"Safety Regulation and Firm Size: Effects of the Coal Mine Health and Safety Act of 1969" by George R. Neumann and Jon P. Nelson, in *Journal of Law and Economics*, vol. 25 (October 1982), pp. 183–199.

Coal mining has traditionally experienced more serious accidents than any other U.S. industry, and over the years Congress has passed successively more stringent laws to regulate safety in the mines. The most recent of these is the Coal Mine Health and Safety Act of 1969. In its 500-odd separate provisions, it laid down specifications for everything from roof supports to machinery design, and it created a new agency, the

Mining Enforcement and Safety Administration, to inspect each mine at least four times a year and certify approval of equipment and operating procedures. MESA grew extremely rapidly, from 327 inspectors in 1970 to 1,521 in 1972 (divided about half and half into safety and health specialists).

The 1969 law apparently succeeded in cutting the death rate in the mines, at a significant cost in reduced productivity and lost competition from small mines, according to George Neumann of the University of Chicago Graduate School of Business and Jon Nelson of Pennsylvania State. It also, ironically, seems to have increased the rate of nonfatal accidents. These conclusions result from a study in which the authors examined data on safety, productivity, and firm size in underground coal mining for the period 1950–76, controlling for such variables as wages, the cost to firms of accidents, and technological changes.

It is not entirely clear what sort of market failure the new law sought to redress. Beginning well before 1969, the labor contracts negotiated by the United Mine Workers of America (which until recently covered more than 80 percent of underground coal workers) had dealt directly with safety issues. This means, the authors say, that there was little reason to suspect that some flaw in the labor market prevented workers from demanding safety, as is sometimes charged in other industries. It is of course conceivable, they say, that UMWA negotiators undervalued safety and health because of the union's unusual political structure, which allows retired miners to vote in elections. One support for this hypothesis is the fact that the ratio of retired to working miners was rising in the years before the act passed.

Productivity dropped after the act was passed from 13.72 tons of coal per worker-day in 1970 to 8.50 tons in 1976. Of this decline, however, the authors say only about one-third, 1.74 tons, can be traced directly to the effects of the act. At the same time, there was a tendency for small mines to shut down, which provided a countervailing trend since the smaller mines generally had lower productivity and had thus been dragging down the average. If the disappearance of small mines can be attributed entirely to the act, that cancels out about 0.19 tons/day of the loss, leaving it at 1.55 (1.74—0.19) tons/day.

The authors point out that any safety legislation, effective or not, is likely to reduce productivity as conventionally measured, since it diverts resources to the "production" of safer working conditions. Likewise, any safety legislation is likely to harm smaller firms disproportionately, to the extent that the production of safety is subject to genuine economies of scale. In both cases, the question is whether the gains in safety outweigh the decline in the production of other valued goods.

The drop in the fatal injury rate after the 1969 law was passed is simultaneously "relatively large" and "imprecisely determined," the authors say. The evidence suggests that sixteen fewer miners perished in 1976 as a direct result of the act, and that the shift in industry composition caused by the departure of small firms led to an additional saving of four lives. But the accident rate actually rose rather than fell after 1969, the magnitude of the change (after adjusting for other factors) being about 25 percent. The authors suggest two explanations for this counterintuitive result. The first is that the act brought about more detailed and presumably more accurate reporting of accidents. Some accidents, notably those which did not keep victims off the job for significant periods, had not previously been reported but show up in the later data. This, however, does not seem to explain the whole story, the authors say. Excluding from the data the least serious accidents, those involving three or fewer lost worker-days, diminishes the effect somewhat but leaves it at a statistically significant level.

Alternatively, the law might have altered working conditions so as to substitute nonfatal mishaps for fatal accidents. (The 1969 act, like some of the earlier laws, was passed in response to a mining disaster with numerous deaths.) The authors note that it is hard to reach any consensus on what sort of trade-off would be appropriate—or technologically feasible—between deaths and crippling injuries.

Neumann and Nelson also ask whether it would be less costly to society to achieve a given level of safety by improving the performance of particular firms rather than driving smaller, less-safe firms out of the industry. The small mines have for years provided strong competition to the UMWA and the Bituminous Coal Operators Association, the major producers' group. A series of complaints, upheld in Su-

preme Court decisions, has stymied what was found to be concerted action by both of these parties to drive the small mines out of business. Now, the authors say, the 1969 law may have succeeded where earlier collusive efforts had failed—an example of, if not "capture," at least creative use of regulation by the regulated.

Measuring White House Influence over Independent Regulators

"Regulatory Performance and Presidential Administration" by Terry M. Moe, in *American Journal of Political Science*, vol. 26, no. 2 (May 1982), pp. 197-224.

In theory, independent regulatory commissions are insulated from presidential influence. Like the courts, they follow elaborately structured decision-making processes, and the decisions they render are seldom subject to review by the executive branch. Although their members, unlike federal judges, periodically come up for reappointment, it is intended to be difficult for any one President to appoint a majority, because of the long and overlapping terms of service and especially because some partisan balance is usually required.

In practice, as is widely recognized, the independent commissions have never been entirely independent or nonpolitical. The President, in particular, has a wide range of resources to use in influencing agency policy. Since 1950, the President has had the power to appoint and remove commission chairmen, and these chairmen have in turn acquired new authority over commission staff and resources. Agencies must clear their budgets with the Office of Management and Budget before sending them to Congress. Also, many commission members resign when the White House changes hands, and those that remain often feel morally obliged to yield to the new President's electoral mandate.

It is sometimes asserted that in fact Presidents do not use their powers much to change commission policy—that they, for example, use regulatory appointments to fulfill political obligations rather than to install adherents of their own philosophy. It is sometimes added that this inaction is due to presidential lack of interest in the often arcane subject matter of the commissions. In this paper, Terry M. Moe of Stanford University constructs a theoretical model to test just how political the commissions are, and in particular to measure presidential impact on the behavior of three regulatory commissions: the National Labor Relations Board, the Federal Trade Commission, and the Securities and Exchange Commission. Using data covering administrations from Truman through Ford, he finds that the agencies' behavior is consistent with the theory of systematic presidential influence.

To measure regulatory "performance," the dependent variable in the model, Moe takes the number of enforcement actions against business (or, in the case of the NLRB, the ratio of anti-management to anti-union enforcement actions). He then maps this variable's systematic fluctuation over time (in an "interrupted time series analysis") to see if a change in administrations is associated with a shift in regulatory commission behavior away from the expected path.

The model works as expected for only one of the agencies, the NLRB. In line with the public pronouncements of the parties themselves, the board seems to have been on the whole more pro-labor in Democratic administrations, and more pro-business in Republican ones, with a statistically significant correlation. The evidence on the FTC and SEC, however, is counterintuitive. Moe finds that these two commissions pursued stricter measures against business during Republican years, just the reverse of what conventional wisdom would predict. In an effort to confirm this anomalous finding, Moe checked the enforcement record of the Antitrust Division of the Department of Justice, which is presumably under more direct political oversight than the independent commissions. There, too, he found that Republican administrations filed more enforcement actions.

One possible explanation for the phenomenon, he says, is that Republicans can enforce "anti-business" regulations at little political cost precisely because they are known as the pro-business party. Moe also speculates that strict SEC and antitrust enforcement often works to the benefit of a majority of politically influential firms and thus is welcomed as "probusiness."