

THE PRIVATIZATION DEBATE: AN INSIDER'S VIEW

Steve H. Hanke

Not content with justifying the idea of private property, I should like to make it appealing even to the most rabid partisans of public ownership.

Frederic Bastiat (1850)

The federal government's land holdings, which are six times larger than France, are a serious problem, symptomatic of a grave disease.¹ The cure is privatization.²

Even though it is most tempting to lash out at the rabid partisans of public ownership, we chose not to take this course. Instead, our observations are addressed primarily to those who favor privatization, but have lost their way.

Why a Public Lands Debate?

Under a system of public ownership, politicians, bureaucrats and special interest groups determine, through political-bureaucratic processes, how resources will be used. Debate and tension charac-

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The author is a Professor of Applied Economics at The Johns Hopkins University, Baltimore, Md. 21218. He was one of the architects of President Reagan's privatization program, and served as a Senior Economist on the President's Council of Economic Advisers.

¹For recent evidence, see S. H. Hanke, "Privatize Those Lands," *Reason*, March 1982; idem, "Grazing for Dollars," *Reason*, July 1982; idem, "Selling Federal Lands," *Inquiry*, September 1982; idem, "On Privatizing the Public Domain," in P. N. Truluck, ed., *Private Rights and Public Lands* (Washington D.C.: The Heritage Foundation, 1983); and idem, "Department of the Interior Land Policy," in R. Holwill, ed., *Mandate for Leadership* (Washington D.C.: Heritage Foundation, 1983).

²Since there have been numerous attempts to distort the meaning of privatization, some definitions are in order: privatize: to invest control and ownership to a private person or private legal entity; privatization: the action or process of privatizing.

terize this ownership system. And, from time to time, the bureaucratic-political processes that accompany public resource use decisions break down, particularly when changes in demands and/or resource supplies occur. Breakdowns, of course, lead to open conflict.

At present, open conflict between commercial and noncommercial users of the public lands exists. It is the result of factors which have dramatically reduced the political access of the commercial users and also the quantity of public lands that are available for commercial uses.

To bring the picture into focus, we use events associated with the allocation and use of the 155 million acres of federally owned grazing lands. As an indicator of reduced access to the political-bureaucratic processes, we only need to mention that ranchers comprised 100 percent of the National Public Lands Advisory Council (formerly, National Advisory Board Council) in 1940; their representation was reduced to only 12 percent by 1980.³ Accompanying reduced political access has been a sharp decline in the public range capacity allocated to commercial livestock: From 1959 to 1980, the grazing forage or animal unit months (AUMs) authorized for commercial livestock declined by 40 percent.⁴ Further reductions in livestock AUMs will no doubt result from environmental impact statements on the grazing program and wilderness reviews, the former being mandated by a court case and the latter by the Federal Land Policy and Management Act of 1976.⁵

If reduced commercial capacity allocations were not enough, non-commercial users of public lands have come very close to convincing the Office of Management and Budget personnel that the grazing fee formula should be modified.⁶ This death wish would have the effect of increasing the price ranchers are required to pay for the AUMs allocated to livestock use. Hence, it would reduce the number of AUMs that ranchers actually purchase.

Faced with these dramatic changes and continued threats, the political-bureaucratic process for allocating public grazing lands was bound to break down. The first formal manifestation of the frustration came from Nevada, a state in which the federal government owns 86

³R. M. Cawley, "The Sagebrush Rebellion" (Ph.D dissertation, Colorado State University, 1981).

⁴U. S. Department of Interior, Bureau of Land Management, *Public Land Statistics* (Washington D.C.: Government Printing Office, 1980).

⁵*Natural Resources Defense Council, Inc., et al. v. Rogers C. B. Morton et al.* (D.C.) 388 F. Supp. 829 (1974).

⁶This is based on personal observations made during the final stages in the preparation of the Budget of the United States, FY 1983.

percent of the land. In 1979, the Nevada State Legislature passed Assembly Bill 413 by a vote of 55 to 4, with one abstention. This bill declared that the State of Nevada was the legal owner of federal public domain lands within the state's boundaries.

Nevada's claim gave birth to the so-called Sagebrush Rebellion, the objective of which was to transfer lands to state ownership. The rebellion quickly spread to other Western states, and was framed as a states-rights issue in which the rebels were attempting to transfer land ownership and control from Washington to their respective state capitals. By accomplishing this, the rebels thought they could once again dictate land-use policy.

Breaking New Ground

During their review of public land policies, President Reagan and some of his advisers realized that the solution offered by the Sagebrush Rebellion was fundamentally flawed: It would merely substitute one *form* of public ownership and political-bureaucratic process for another. As such, it offered no *substantive* solution for the problems inherent in government ownership and control of land and other resources.⁷

The President broke new ground on the public lands issue in his Budget Message for Fiscal Year 1983, when he endorsed the goal of privatizing the public lands:

[W]e will move systematically to reduce the vast holdings of surplus land and real property, [since] some of this property is not in use and would be of greater value to society if transferred to the private sector. In the next 3 years we would save \$9 billion by shedding these unnecessary properties while fully protecting and preserving our national parks, forests, wilderness and scenic areas.

In addition to his budget statement, the President issued Executive Order 12348 on February 25, 1982, which established a Property Review Board as part of the Executive Office of the President. The Board was directed to:

- develop and review federal real property acquisition, utilization, and disposal policies;
- advise the administrator of the General Services Administration (GSA) in setting standards and procedures to ensure that real property no longer essential be promptly identified and released for appropriate disposition;
- review prior disposals of surplus property made at discounts for

⁷For the theoretical underpinnings of this analysis, see Ludwig von Mises, *Socialism* (Indianapolis: Liberty Classics, 1981).

the "public good" to ensure that the property is being used and maintained for the purpose intended;

- receive the reports made by or to the GSA on federal real property, placing particular emphasis on resolving conflicting claims on and alternate uses for property described in these reports;
- establish a target amount of real property to be identified as excess for each executive agency.

The Executive Order also required the head of each federal agency to survey public property holdings and identify those that were underutilized or unused. Real property identified by the various agencies and the GSA as surplus was ordered to be promptly made available for its most beneficial use.⁸

The President's privatization policies would generate considerable benefits for the nation. For example, the following benefits would result from privatizing federal grazing lands.

1. The productivity of Western grazing lands would increase, and the cost per unit of output would fall, since private land owners would not have to jointly manage lands with federal bureaucrats.

2. Consumers would be served more effectively and lands would be allocated to their most highly valued uses. After all, the only way that private land owners can profitably enjoy their property is to employ it for the satisfaction of other people's wants. The only way the land owners can take advantage of what they own is to serve consumers. This, of course, is the social function of private property.

3. Current federal revenues would be generated and earmarked to retire the national debt. Hence, the liabilities we bequeath to future generations would be reduced.

4. The annual federal costs (which incorrectly omit capital carrying charges) exceed the annual revenues generated from federal grazing lands. Therefore, privatization would eliminate negative cash flows for the federal government. This would obviously benefit all U. S. taxpayers, who must now pay taxes to support the federal government's retention of public grazing lands.

5. A state and local tax base would be created. Western dependence on in-lieu payments from Washington would be eliminated and federalism would be enhanced.

6. Land-use decisions would become less politicized, and commercial and noncommercial land users would have to spend less of

⁸It is important to note that the President's privatization policies were developed and will be administered within the Executive Office of the President. Also, these policies are not new. They are very similar to those advocated by Alexander Hamilton and adopted between 1787 and 1862, when about 155 million acres of public land were sold to generate revenue to retire the Revolutionary War debt.

their time and money attempting to obtain land-use rights through the political-bureaucratic processes.

The Simple Analytics of Privatization: The Case of Grazing Lands

Until the passage of the Taylor Grazing Act in 1934, the public domain was operated as a large commons. Since the Act, a more orderly method of utilization has been in effect. For the right to use public grazing lands, ranchers must acquire grazing permits. To obtain these permits, ranchers must pay annual rents to the U. S. government. By custom, the grazing permits are attached to specific parcels of private land.

The linkage between public permits and private land has had a profound impact on the market for private land. The annual public grazing fees have been set below market-clearing levels. As a result, the grazing permit market has been cleared—supply has been equated with demand—not through the public grazing permit market itself, but through the market for the private lands that are linked to public permits. The difference between the public grazing fees that are charged and those that would clear the market for grazing permits has been capitalized into the value of the private lands that permits are attached to.

The linkage, through the capitalization process, between the market for public permits and that for private land, has important implications. With the exception of those who obtained the original permits, all ranchers have had to pay two prices for their public permits—a public price, in the form of an annual grazing fee, and a private price, in the form of a higher price for private ranch land.

When ranchers purchase a private ranch with public grazing permits attached to it, they are purchasing two items: the private ranch land and the right to purchase public permits at a price set below the market-clearing level. In short, the ranchers are purchasing a property interest in the public lands. This is, of course, recognized in the market place and is reflected in the premiums paid for private ranch land. It is also recognized by private and public bankers who specifically identify the premiums and use them as collateral when ranchers obtain bank loans. The property interests that private ranch owners have in public lands is also recognized by the Internal Revenue Service for inheritance tax purposes. Given the private and public recognition of these private property rights in public lands, the federal government should honor them.

To privatize public grazing lands and transfer surface rights to

private ranchers, while honoring the legitimate private rights that ranchers already have in these public lands, we must first compute the value of the land that the ranchers have not already paid for; that is, we must estimate the present value of rental payments which would be required if ranchers were to retain their use rights on the public lands. This value can be estimated by capitalizing over a 50-year period (at between one and two-and-one-half percent real rate of interest) the annual grazing fees (an annual average paid over the past five years in 1982 dollars) that the rancher has paid.⁹

A concrete example illustrates how to compute this value (the first-refusal price). The ranch in question is operated as a single unit. However, its lands are distributed in the following ownership pattern: 4,816 acres are privately owned, 8,333 acres are owned by the state government; and 1,500 acres are owned by the federal government. Table 1 summarizes the steps required to apply the formula for determining the first-refusal price, or the value of the federal land that the rancher has not already paid for through premiums on his private land. The value in this case is \$18.88 per acre.

Once the first-refusal price calculation is completed, we can determine the terms of sale for privatizing public grazing lands. There are two possible formats for privatization. The first format would require that each rancher be offered an option to purchase, on a first-refusal basis, the public grazing lands that he now rents from the government. The first-refusal price should be set so that the ranchers are only charged for that portion of the public lands' value that has not already been paid for through premiums on private land. In our example, the option would be offered at a first-refusal price of \$18.88 per acre.

If a rancher should fail to exercise his option, then the lands in question should be sold to the highest bidder at a public auction. Since, in this case, the rancher's lease-hold rights in the public lands would be sold, the government should compensate the rancher for the decreased capital value of his private ranch land.¹⁰ This compensation should be equal to the differences between the price received

⁹The recommended real rates of interest are based on the real rates that could have been obtained at Federal Land Banks (1950-1980, mean = 2.47 percent, and the five-year average is an estimate of annual future fee payments).

¹⁰Recall that the rancher paid for the government's under-priced grazing rights when he bought his ranch, expecting to capture the benefits from such rights into the distant future. When the government sells its grazing lands to an "outsider," the rancher will incur an unexpected capital loss in the form of a decrease in the value of his private ranch land. Since the government land-use policy initially forced the rancher to pay a premium for his property, he should be compensated for the subsequent capital loss imposed by the government's policy switch toward privatization.

Table 1
First-Refusal Price Calculations for Grazing Land

Step 1: Adjust Lease Payments to 1982 Dollars

(1) Year	(2) Payments in Current \$	(3) Inflation Adjustment Factor	(4) = (2) × (3) Payments in 1982 \$
1977	\$616	1.50	\$ 924
1978	616	1.41	869
1979	771	1.31	1,010
1980	963	1.20	1,156
1981	942	1.09	1,027

Step 2: Calculate Average Annual Lease Payment in 1982 Dollars

<p>Total Payments in 1982 \$ = \$4,986 Total Number of Years = 5 Average Annual Lease Payment in 1982 \$ = \$4,986/5 = \$997</p>
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Step 3: Capitalize Average Annual Lease Payment to Determine First-Refusal Price

<p>Average Annual Lease Payment in 1982 \$ = \$997 Capitalization Factor at 2.5% for 50 years = 28.4* First-Refusal Price = \$997 × 28.4 = \$28,315</p>

Step 4: Calculate the First-Refusal Price Per Acre

<p>Total First-Refusal Price = \$28,315 Total Acres Under Lease = 1,500 First-Refusal Price Per Acre = \$28,315/1,500 = \$18.88</p>

*Capitalization factors for 50 years and 1, 1.5 and 2.0 percent are 39.2, 35.0 and 31.4, respectively.

at the auction and the first-refusal price. Again, with reference to our example, if the rancher failed to exercise his option at the first-refusal price of \$18.88 per acre and the land was sold for \$28.88 per acre, then, to honor the rancher's property rights, the government would have to compensate the rancher at a rate of \$10 per acre.

The second format for privatization would be a straight public auction. In this case, however, all participants in the auction would not be operating on an equal footing. Ranchers, who own lease-hold

rights in the public lands, would have these rights honored by the government. If a rancher was the highest bidder at the auction, he would receive a credit equal to the difference between his bid and the first-refusal price. Hence, a rancher would only be required to pay the government the first-refusal price or that portion of the land's value that he has not already paid for. In our example, the rancher would receive enough credits to make his net price to the government equal to \$18.88 per acre.

If a rancher with existing lease-hold rights in the public lands (grazing permits) was not the highest bidder, he would not receive title to the land in question. However, to honor his rights, the government should pay the rancher compensation for the value of his lost assets. This value would again be equal to the difference between the price received at the auction and the first-refusal price. In our example, if an "outsider" made the high bid of \$28.88 per acre, the rancher would receive compensation at the rate of \$10 per acre.

Asset Hoarding: A Cancer From Within

Instead of cataloguing the opponents to privatization and refuting their arguments, it is more instructive to note the economic essentials of the bias toward asset hoarding in the public sector.¹¹ The fact that government officials do not have to pay capital carrying charges or rents for the assets they control means that no costs have to be budgeted for holding public assets. Once assets are under government ownership and control, they are viewed by bureaucrats as being free—nothing must be given up for the assets' use and retention. Furthermore, if a decision is made to dispose of public assets, the revenues from their disposal are usually not earmarked for use by the department or agency that initiates the sale. Hence, there are no bureaucratic or budgeted benefits that flow from the liquidation of government property. But, there may be significant costs to bureaucrats from public asset liquidation. For example, if the Bureau of Land Management (BLM) and the U. S. Forest Service liquidated the lands they manage, they would significantly reduce their employment opportunities and growth potentials, since the Forest Service's and BLM's *raison d'être* is to manage federal land.

The bias toward asset hoarding in government represents a real problem that has not been altered by the President's privatization program. Indeed, there is strong evidence to suggest that government

¹¹This bias only applies to physical assets. For working capital, the bias is toward dis-
hoarding.

bureaucrats have been effectively protecting their asset-hoarding bias and undermining the President's privatization efforts. Some of the President's own appointees have even expressed their reluctance to use the term "privatization." For example, at a recent meeting of the National Public Lands Advisory Council, the Assistant Secretary for Land and Water at the Department of the Interior stated that he "abhorred the word privatization and asked that the council members never use it."¹²

Another variation of the attack on the concept of privatization has been carefully spelled out by civil service bureaucrats. Commenting on a paper delivered by Professor Joseph Sax at a recent conference on privatization, the Director of the Office of Policy Analysis at the Department of the Interior stated:

Professor Sax's paper is a valuable exposition of several important public issues regarding the sale of Federal lands into the private sector. It is important to note, as Professor Sax did in his presentation, that the issues he discusses have little bearing on the current Asset Management Program of the Federal Government. Instead, he is talking about what is commonly known as "privatization," a large scale divestiture program proposed by academics who are not a part of the current Administration. By contrast, the Asset Management Program is a small, careful, and responsible program involving land sales following extensive planning and public involvement.¹³

By distorting the meaning of the word "privatization" (see note 2) the President's critics have been able to assert that they are supporters of the Asset Management Program—a modest proposal for privatization—while at the same time opposing privatization.¹⁴ If the President's program is to be a success, the bureaucratic bias toward asset hoarding and the double talk about privatization must be recognized and effectively dealt with. The cancer from within must be arrested.

Two treatments should be applied. The first involves White House attention to the program. All that is required is for the President to express to his staff, and more specifically to his political appointees

¹²Ben Avery, "Sale of Public Land Draws Opposition," *The Arizona Republic*, October 7, 1982

¹³Comments on a paper by Joseph Sax entitled "For Sale: A Sign of the Times on the Public Domain," delivered at the National Workshop on Rethinking the Federal Lands, sponsored by Resources for the Future, September 8-10, 1982, in Portland, Oregon.

¹⁴For a healthy reaction to this type of double talk, see Margit von Mises, *My Years with Ludwig von Mises* (New Rochelle, N.Y.: Arlington House, 1976), pp. 145-146.

in the Departments of Interior and Agriculture, his personal interest in privatization.¹⁵

The second treatment that should be applied is *genuine* asset management. The objective of holding a portfolio of commercial lands, such as those subject to review under the President's directives, should be to earn a target rate of return. Therefore, if asset management is to be taken seriously and the bureaucratic bias toward asset hoarding is to be overcome, the President's Property Review Board should require that all lands that do not yield a real rate of return of 10 percent under public ownership should be classified as surplus and privatized.¹⁶ This second treatment would add discipline and accountability to the President's Asset Management Program.

Concluding Observations

The President's modest program to privatize a limited amount of commercial land has received a great deal of negative press coverage. Journalists have been overwhelmed by the negative emotional responses from environmentalists and bureaucrats who oppose *any* attempt to sell off federal lands. In general, the media has failed to understand the economic logic behind privatization and the social benefits that would result. Therefore, the courting of journalists and politicians by environmentalists and bureaucrats has resulted in the deluded leading the blind.

These facts notwithstanding, there is cause for optimism about privatization, for the privatization debate has begun to stir the instinct for freedom from government coercion. The real issue in the privatization debate is coming to the forefront: the choice between capitalism and socialism, or between private property and individual freedom versus public ownership and serfdom. Given the growing public sentiment for privatization, it is somewhat puzzling that conservative politicians have failed to rally behind the privatization drive; but this is not the first time that conservatives have failed to support the principles of a free society.¹⁷ This is changing, however, as more citizens ask conservative politicians to account for their stewardship and weak stand on the issue of our nationalized lands.

¹⁵I have observed that expressions of personal interest by the President have a sobering affect on political appointees. For example, the President's initial personal attention to privatization guaranteed that the program was swiftly developed exclusively within the Executive Office of the President. Great care was taken to avoid sabotage by bureaucrats and political appointees who were located outside the EOP.

¹⁶For a technical treatment of this target rate of return criterion and the details for implementation, see Hanke, "Department of the Interior Land Policy."

¹⁷For a well-researched volume on conservatives' support of socialist policies, see Gabriel Kolko, *The Triumph of Conservatism: A Reinterpretation of American History, 1900-1916* (Glencoe, Ill.: The Free Press, 1963).