ECONOMIC THEORY

Producing Public Goods Privately

The Appalachian Mountain Club shows that government is not the only means to address market failure.

BY PIERRE LEMIEUX

In his 1840 book *Democracy in America*, French political theorist Alexis de Tocqueville lauded the role that voluntary associations played in the United States. "Americans of all ages, all conditions, and all dispositions constantly form associations," he wrote. "Wherever at the head of some new undertaking you see the government in France, or a man of rank in England, in the United States you will be sure to find an association.... I have often admired the extreme skill with which the inhabitants of the United States succeed in proposing a common object for the exertions of a great many men and in inducing them voluntarily to pursue it."

America has changed much since de Tocqueville wrote, but the role of private, voluntary associations has survived. An example is the Appalachian Mountain Club (AMC), a 501(c)3 nonprofit organization founded in Boston in 1876. The "oldest recreation and conservation organization" in America, the AMC lists its mission as "the protection, enjoyment, and understanding of the mountains, forests, waters, and trails of the Appalachian region." The AMC focuses on the New England and mid-Atlantic areas, where its volunteers maintain 1,500 miles of trails, including in the White Mountain National Forest, which covers more than 700,000 acres in New Hampshire and Maine, and is administered by the U.S. Department of Agriculture. AMC volunteers also help maintain the northern part of the Appalachian Trail, a wild footpath that runs more than 2,000 miles from Maine to Georgia. The association publishes trail and mountain guides, including the famous *White Mountain Guide*, which has gone through 29 editions since 1907. Its staff and volunteers participate in search-and-rescue missions for lost or injured hikers. It maintains shelters, campsites, and lodges, and organizes guided programs, training classes (on fishing, for example), and outdoor learning experiences for schoolchildren.

The association employs 450 full time and seasonal staff, coordinates the work of several thousand volunteers every year, and boasts a dues-paying membership of more than 83,000. At the end of 2011, its balance sheet showed $113 million in assets. Its annual expenses total $29 million, of which it reports that some 98 percent comes from private sources.

The AMC's Maine Woods Initiative was launched in 2003 with the purchase from International Paper of 37,000 acres of land in the 100-Mile Wilderness region. This region runs east of Moosehead Lake up to Mount Kathadin in Maine, over a distance of 100 miles where the Appalachian Trail does not cross any paved road. In 2009, the AMC purchased another contiguous 29,500 acres from Plum Creek, a timberland real estate owner. Henry David Thoreau's travels in these countries, through both Moosehead Lake and Mount Kathadin, inspired his 1864 book *The Maine Woods*: "On the 31st of August, 1846, I left Concord in Massachusetts for Bangor and the backwoods of Maine." A press release by the AMC after its second land purchase in Thoreau country notes that "[n]o public funds were used in the acquisition."

Pierre Lemieux is an economist affiliated with the Department of Management Sciences of the Université du Québec en Outaouais. His new book, *The Public Debt Problem*, will be released by Palgrave-Macmillan in January.

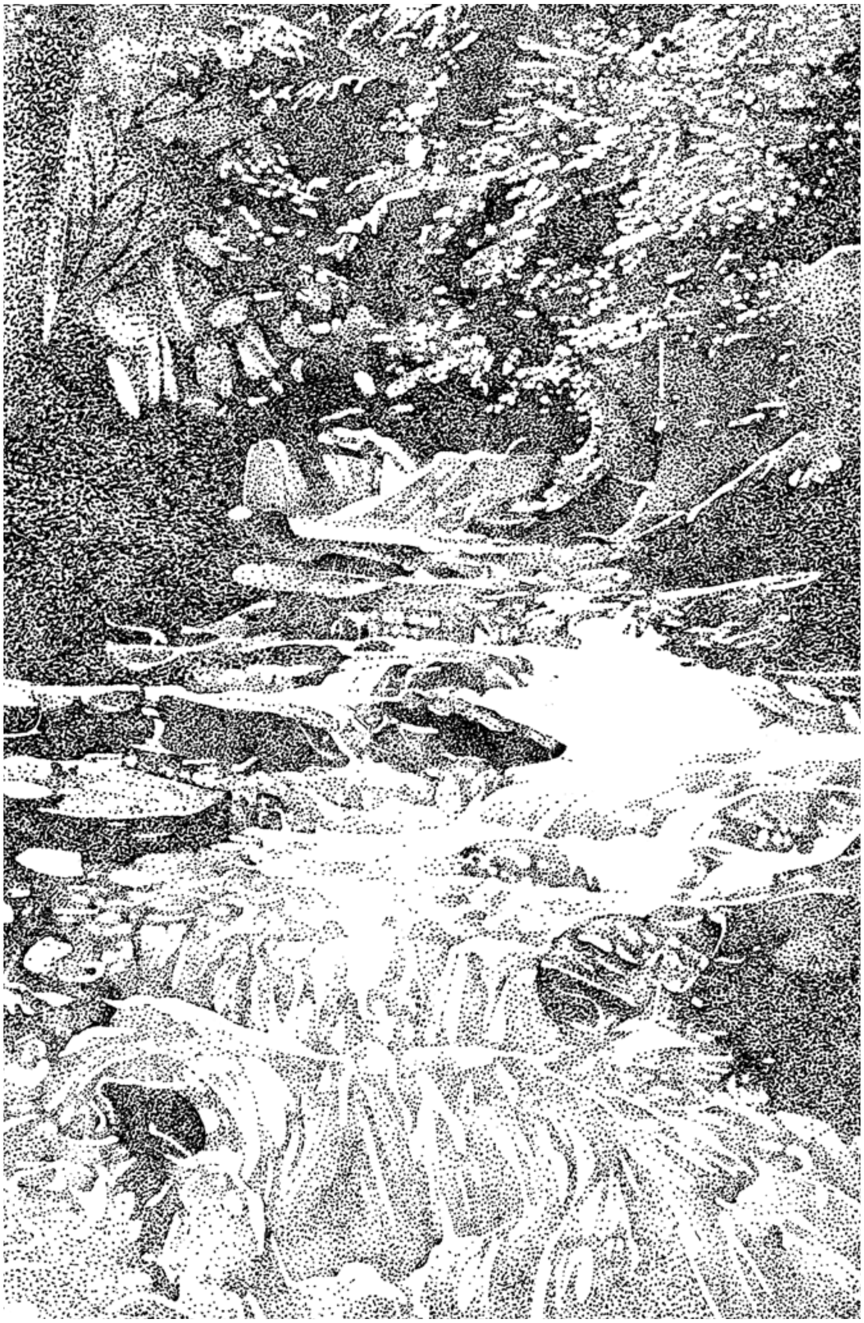

ILLUSTRATION BY MORGAN BALLARD

Public Goods

Modern economic analysis, which de Tocqueville could not have known, defines "public goods" as goods or services that can be jointly and simultaneously consumed by a large number of people, and from the consumption of which it is difficult to exclude free riders. The concept was formalized by economics Nobel Prize winner Paul Samuelson in the 1950s. Economists have long argued that because of the free rider problem, public goods will be underproduced on the market, if produced at all, as everybody waits for his neighbor to finance their production. Standard examples of public goods include national defense, public security, lighthouses, and public places like roads and streets. Wilderness areas made available ("produced" in economic jargon) by the AMC and other similar organizations qualify as well.

In reality, we observe that public goods are often produced by private interactions. The AMC is only one example. In a famous 1974 article, Ronald Coase, another Nobel Prize winner, showed how British lighthouses were in fact built and operated by private entrepreneurs in the 19th century (albeit with some help from customs agents who collected fees at the ports). Game theory later showed how social rules can evolve to promote social cooperation, which is a public good (Robert Sugden provides a good treatment). Political scientist Elinor Ostrom (yet another economics Nobel Prize winner) analyzed historical cases where common pool resources (water, forests, etc.) were regulated by spontaneously evolved rules of cooperation.

Most, if not all, public goods are "goods"—that is, desired things—only for certain groups of people. As only navigators needed lighthouses, only forest lovers want wilderness areas, trails, and mountain shelters. Private associations are thus a promising way to provide the public goods that their members desire. Getting over the free rider problem—that is, getting beneficiaries to become members and to voluntarily contribute to the production of their preferred public goods—is what economist Mancur Olson identified as the problem of collective action. In his seminal 1965 book *The Logic of Collective Action*, he showed that the problem is not insurmountable: an association can motivate participation by providing its members with "selective incentives" in terms of private benefits.

The AMC exemplifies the capacity of private associations to provide public goods to their members. This past summer, some 7,000 paying visitors stayed at one of the AMC's Maine Wilderness lodges. These facilities are private goods, as there is a limit to the number of persons a bed can hold, but the wilderness around them is a public good for those who enjoy it. Lodges are accessible to members and nonmembers, but the latter have an Olsonian incentive to purchase a membership in order to get the 10–20 percent member discount. The discount on a one-night couple's stay in a cabin makes up for a large part of an annual family membership fee.

The selective incentives tied to membership don't account for all of the AMC's financing. While about 10 percent of the association's annual revenues are from membership dues, close to a third come from donations. Americans are known to be great contributors to private charity. With the AMC as with other charities, the donor obtains utility from contributing to activities he likes, and from being part of a congenial fraternity. But donors also respond to evolved moral rules that induce individuals to contribute to social activities that benefit them. As many of the AMC's donations are large ones, another feature of the economics of public goods production may be at work: David Haddock of Northwestern University explains that a large consumer-to-be of a given public good may find it in his interest to personally finance a certain level of the good's production. Finally, typical American entrepreneurship plays a role in the financing of the AMC: nearly half of the club's revenues come from its paying activities. There are many ways to finance public goods privately.

Tainting of Private Associations

Since government is now everywhere, private associations are often entangled with—and tainted by—government through joint projects, lobbying, and subsidies or other privileges. In this area as in others, the distinction between private and government activities has become blurred. But the AMC has kept its distance from Leviathan better than many other associations. It is essentially financed by commercial activities, donations, and membership dues. The AMC does carry out joint projects with government organizations: for example, it offers wilderness programs to public schools, provides trail maintenance in the White Mountain National Forest, and conducts rescue operations in cooperation with government agencies. But in such activities, the association is playing a support role and generally receives no payments from government.

Lobbying is a more complex issue. The main historical examples of its lobbying cited by the AMC include promotion of the Weeks Act of 1911, which allowed for the use of federal funds (in cooperation with state governments) to purchase land for national forests. One can argue that this four-page law was relatively innocuous and in line with John Locke's famous proviso to homesteading that there be "enough, and as good left in common for others," although it remains questionable why the federal level should be involved. In 1975, the AMC won an injunction against the construction of a freeway through Franconia Notch State Park in New Hampshire because of a defective Environmental Impact Statement. This gets closer to using the state to operate redistribution in favor of one's pet projects but, on the other hand, publicly built freeways are not necessarily economically efficient. The AMC also lobbied for the 2004 Highlands Conservation Act, which belongs to the same category as the Weeks Act. Of course, neglecting Locke's proviso, when taxpayers are forced to pay taxes so that the government may buy their properties, the result can be viewed as stealth expropriation.

The AMC's fundraising letters to the membership typically do not suggest that recipients contact their elected representatives, asking instead for voluntary, independent efforts and money to support tasks like repairing the damage caused in the White Mountains by Hurricane Irene in August 2011. However, its Conservation Action Network, which AMC members can choose to join, does recommend contacting politicians about conservation issues. According to its latest IRS public filing (Form 990), the AMC spent $100,000 on lobbying in 2010, a tiny portion of its budget, and most of the spending went to grassroots lobbying (lobbying to influence public opinion as opposed to actual contacts with legislators). All in all, the AMC seems to act more like a private producer of public goods than a rent seeker.

The AMC is not totally immune to the temptation of government subsidies and privileges. In 2005, the State of Maine purchased for $4.4 million a conservation easement on the first tract of land the AMC had bought in 2003 under its Maine Woods Initiative. Unless the AMC seriously believes that the government will be more efficient than itself in preserving the vocation of the land, this looks like a disguised subsidy. Indeed, the money came from the U.S. Department of Agriculture's Forest Legacy Program, which combines with state governments to help conservation organizations buy private land or easements on such lands. The USDA boasts that the Forest Legacy Program is "an entirely voluntary program," which is true if you forget the taxpayers who coughed up the money in the first place. If we include the easement purchase and other subsidies from the State of Maine, the proportion of public financing on the 2003 land purchase reaches 42 percent.

It is true that, for the AMC's second land purchase in 2009, "[n]o public funds were used," but the purchase was financed through federal tax credits. Actually, a financing of the same sort had provided a temporary loan for the 2003 land purchase. To finance these two acquisitions, the AMC borrowed $31 million through structured financings sponsored by CEI Capital Management (CCML). CCML is a for-profit subsidiary of Coastal Enterprises Inc. (CEI), a community development organization based in New England. CCML structured the $31 million loans by attracting investors with a 2000 Treasury Department program called the New Markets Tax Credit, which gave federal tax credits of 39 percent on qualified projects. Special purpose entities (a type of structured-finance vehicle) were created to funnel the loans. Of course, investors push yields down by competing for the tax advantage, and the borrower obtains an interest rate below market. The AMC has now reimbursed most of the loans and is on schedule to reimburse the remainder in 2014. With its large balance sheet—already at $49 million before the 2003 purchase, including $22 million in portfolio investment—and high annual revenues, the AMC could have financed $31 million in real estate purchases without subsidies, but a lower interest rate provides an irresistible temptation.

It can be argued that once a government program exists, somebody cannot be faulted for taking advantage of it. Obviously this argument has its limits, which are crossed when a corporate body actively tries to secure protectionist measures or other privileges against competitors. But it is difficult in today's world to blame somebody who, without any extraordinary effort, accepts money that is an infinitesimal part of government expenditures and would be given to somebody else otherwise. Moreover, taking advantage of an existing tax break (like the New Markets Tax Credit program) seems unobjectionable even from a libertarian viewpoint: preventing Leviathan from raising even more money is a blessing. Finally, to paraphrase *John* 8:7, he that is without sin among you, let him cast the first stone at the AMC.

The Buzzword Test

Some of the AMC's partners are not so easily excused. CCML and CEI are quasi-governmental entities disguised as private organizations. As recently as the late 2000s, CEI derived one-third of its budget from federal and state governments. Fannie Mae is even listed among its funders. CEI spares no word and probably no action to cajole the subsidy-granting D.C. nomenklatura. The organization's aim is "to achieve social and economic justice," and "environmental justice for all people," "within sustainable communities," for which it "employs a holistic approach" and "has a robust policy arm"—read: a strong lobbying arm.

CEI's 2011 Annual Report rants about the "haves" and "have-nots" and their "stations in life":

> The various "Occupy" movements—with their global locations—ask that each of us in our respective communities and stations in life do two things: first, understand the chasm between the haves and have-nots: the economic systems that foster income and wealth disparities vs. those that nurture sustainable and healthy communities.

To take another example of CEI's deep understanding of the world, its 2009 Annual Report declared:

> CEI's plan was developed amidst critical domestic and international turmoil, financial chaos, massive war expenditures, and assault on the environment. Comprising only 5% of world population, the U.S. consumes 58% of the world's energy, primarily fossil fuels. Wealth, too, is concentrated among the few, here and abroad.

The CCML subsidiary was created with the purpose, and apparently has as its sole activity, "to help attract capital to low-income areas using the U.S. Treasury Department's New Markets Tax Credit (NMTC) program." Earlier this year, CCML officials testified before a House committee for an extension of the tax credit, which expired at the end of last year (and has not been renewed). They argued for exempting these tax credits from the Alternative Minimum Tax. An observer would be forgiven to conclude that, in this case, CEI does believe that concentrating wealth among the few is desirable. Continuing on the fashionable buzzword slope, CCML's project criteria include to "sustain jobs in an economically challenged area," and "sustain a traditional but challenged industry."

The AMC does much better on the buzzword test, although it is not totally immune to the environmental vulgate. The association speaks of the outdoors resources it protects as having "intrinsic worth." Of course, there is no "intrinsic worth" outside of human preferences: if there were no man on this planet or within a reachable cosmic radius, these resources would be worthless in any ascertainable meaning of the term. The AMC boasts of its local hiring, as if hiring somebody far away and more in need of a job were sinful. As part of its "green promise," it practices "green purchasing" and aims at "reducing its total carbon footprint by 80% by 2050." It favors "sustainable forestry," as if forest exploitation on private property could be anything but "sustainable." Yet the AMC does all this with its own money and on its own property.

The AMC does not buy political and environmental correctness wholesale. For example, it allows hunting on its land as well as the carrying of firearms. Prodded on this topic, a spokesman says that "[f]irearms are allowed on AMC lands in keeping with applicable laws" (which, in Maine and New Hampshire, are quite liberal, in the good sense of the term). "Guests," he adds, "are asked to refrain from carrying firearms within or in the immediate vicinity of a facility," but "local managers can make exceptions." That rule, however, seems to be posted nowhere, so it is difficult to see how somebody carrying a handgun concealed on himself or in his backpack could know. Perhaps the AMC is playing "Don't ask, don't tell"?

Of course, the AMC dwells in our statist world and is colored by it. Yet it remains essentially a private association pursuing private goals dear to its members and supporters, and it is a private supplier of public goods. It has grown expert at using private property for these purposes and could serve as a model for many other associations.

As public debt problems deepen at all levels of American government and the federal government will soon have to choose between reimbursing debt holders, paying Social Security benefits, or dramatically cutting other spending, the role of private associations like the AMC will become even more important. This should be seen as an opportunity. More tainted organizations will have to review their financing and their missions. In barely three years, CEI has seen its federal and state subsidies drop by nearly half, bringing them down to 17 percent of revenues in 2011. To borrow from Bob Dylan: "For the times they are a-changin'." R

READINGS

- *Democracy in America*, by Alexis de Tocqueville. Relevant excerpts in *The Idea of America*, edited by Bill Bonner and Pierre Lemieux. Laissez-Faire Books, 2011.
- "Diagrammatic Exposition of a Theory of Public Expenditures," by Paul A. Samuelson. *Review of Economics and Statistics*, Vol. 37, No. 4 (1955).
- *Governing the Commons: The Evolution of Institutions for Collective Action*, by Elinor Ostrom. Cambridge University Press, 1990.
- "Irrelevant Externality Angst," by David D. Haddock. *Journal of Interdisciplinary Economics*, Vol. 19 (2007).
- *The Economics of Rights, Cooperation, and Welfare*, 2nd ed., by Robert Sugden. Palgrave-Macmillan, 2004.
- "The Lighthouse in Economics," by Ronald H. Coase. *Journal of Law and Economics*, Vol. 17, No. 2 (1974).
- *The Logic of Collective Action: Public Goods and the Theory of Groups*, by Mancur Olson. Harvard University Press, 1965.
- *The Maine Woods* (1864), by Henry David Thoreau. Penguin Books, 1988.
- *The Second Treatise of Government* (1690), by John Locke. Cambridge University Press, 1960.