Steve H. Hanke

The State Wades In

MANAGEMENT of water resources by the government can often encumber their wise development and use. To illustrate this problem, I offer a case study about the life and death of a private water company.

A small private water company was created in 1936. Its purpose was to supply, through a central system, potable water for 300 connections in a stable, rural community.

To protect the public interest, the state regulated the company through its Public Service Commission. The rates charged by the company required the Commission's approval. As a result of the Commission's decisions, the company's water rates were less than the real cost of supplying water.

These artificially low prices resulted in two problems. First, customers were not given the proper incentives to conserve, so their water use increased. This growth taxed the system's capacity, particularly during the hot dry summer months. Lacking the Commission's approval to raise prices or to expand capacity, the company was forced to institute water-use restrictions periodically. These were viewed by the Commission, local politicians, and customers as symptoms of inadequate water service and poor management.

Deterioration of the system—the second problem—began to appear in the 1970s, when components of the original system began to leak. In 1977, the company recognized that capital improvements costing $500,000 were necessary to assure adequate service, and it planned to make these improvements in three stages.

The company's revenues for 1977,

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however, were only $30,000. These were not adequate to cover its operating costs. Since the company could not generate investment funds either by self-finance or by a new bond issue, it applied for a rate increase. This additional revenue would have allowed it to attract financing for capital improvements. The Commission, however, denied the rate request, even though the rates had not been changed since 1968.

After denying the request, the Commission held hearings to determine the adequacy of the existing system and the need for improvements. During these hearings, a government agency alleged that it could obtain a federal grant and that it could use the grant to purchase the company's assets, to make improvements, and to provide water at an annual cost of only $15,000.

The Commission concluded that, even if the water company could finance its improvements, the resulting rates would be burdensome, and that the consumers would be better serviced if the government agency assumed the responsibility for water supply. So the Commission revoked the water company's right to exercise its franchise. It also ordered the agency to assume operation of the system and to apply for the federal grant.

After several months, the agency discovered that it could not meet even its out-of-pocket operating expenses with the existing rates, which generated $30,000 per year. It, therefore, raised rates to $60,000 per year—the level that the Commission had earlier denied to the private water company. The agency could do this because its rates were not regulated by the Commission. Shortly after assuming responsibility for the new system, the agency discovered that money from federal grants could not be used to purchase existing systems. This money could be used only to make new capital investments. The agency correctly concluded that its least costly option was to use a federal grant, which covered 75 percent of any new capital works, to construct an entirely new, duplicate system. A new system was built for $1.2 million. It was financed by $900,000 from a federal grant and $300,000 from the agency.

The mismanagement by the government of a local water problem had produced three unanticipated—and unfortunate—results. A private enterprise was asphyxiated, customers received the same service at a higher price, and resources were wasted, since a government agency spent $1.2 million for a service that could have been provided privately for only $500,000.

Moral: If you allow the government to manage a water problem, you may at first find the solution attractive. In the end, however, you will pay and pay.

Jack D. Douglas

A REBIRTH OF ECONOMIC FREEDOM:
The De-Bureaucratization of American Business

WE AMERICANS have always cherished our economic freedom as a vital pillar in the foundation of our "natural system of liberty." As in Britain before us, we have always cherished the spirit of the independent yeoman or freeholder as the embodiment of this value. As the typical American would put it today, "I don't like taking orders from anyone. I want to be my own boss."

The independent farmer ("freeholder") was both the ideal and the overwhelming economic reality in American life until late in the nineteenth century. (After the invention of the cotton gin in 1793 much of the land of the South became large plantations worked by slaves. But Southerners were far outnumbered by Northern freeholders.) These independent farmers were the backbone of the Jeffersonian-Jacksonian "empire of liberty." Being dependent on no one for their livelihood, as Jefferson argued, they could be counted on to assert their real interests and, thus, to maintain the republican freedoms enshrined in the Bill of Rights.

Jefferson and his successors feared that this republic could not long endure if the freeholder vanished and workers became dependent on others. The corporate concentrations of capital and employment that developed over the century, fueled largely by changes in government laws, especially the introduction of high tar-

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