envisages a continuation of this scheme but with the net cast wider over a larger population of banks. Why could such a scheme not be privately administered? Either the banks will wish to persuade customers of their prudence and offer the guarantee of protection, or an opening in the market will be exploited by another bank. The sole justification for the central bank to organise the insurance rests on its being the ultimate source of cash. That argument takes us to the role of the lender of last resort.

The authorities have the responsibility of maintaining the payment mechanism – the role of lender of last resort, which should not be confused with bailing out insolvent institutions. Even if there were a danger of runs, the existing techniques of the lender of last resort are sufficient to prevent any financial crisis. This assertion is true even where depositors are apprehensive and begin to shift out of deposits and into currency.

The function of lender of last resort is to provide the market with liquidity in times of pressure. It is not to come to the rescue of an institution that has got itself into difficulties. Providing liquidity is achieved by discounting all good 'paper' – bills and similar securities – presented to it. Obviously, the more that is required, the more expensive it will become – the higher will be the rate of interest charged. But if the central bank adopts this procedure, it can remain ignorant of any single institution. There is no reason that it should know the details of any balance sheet. It simply satisfies a demand for funds, at a price. A badly-run institution will be carrying poor-quality paper and in the extreme case will be unable to obtain a high enough price to see it through its difficulties – of its own making. Following this line, the central bank does not have to bother about the oft-quoted problem of distinguishing between insolvency and illiquidity. For it is the market that requires funds in a liquidity crisis, and it is to this market that the central bank should address itself.

The principal objection that can be raised against this behaviour is that the public does not have sufficiently good information. Therefore, when a badly-run bank fails, depositors *may* suspect that their own bank will be under pressure and withdraw their funds. But at some point they will redeposit their funds either with the original bank or another. The system will have experienced a liquidity crisis. The central bank will have calmed the market by providing the necessary funds, if it judges by price, as described above. In any event, the objection is better answered by insisting that there be a better flow of information throughout the market.

The best way of achieving financial stability is to encourage market efficiency. The only safeguards required – those on capital requirements – could be easily imposed. The aim of any new legislation should be to shift the risks of banking to shareholders and away from the taxpayer. EA

[1]Cmnd. 9695 (3.1), HMSO, London.

Market Remedies for State Transport Paralysis

John Hibbs

A recent publication from the National Center for Policy Analysis in Dallas confirms the superiority of the supply of transport through prices in the market over provision by state allocation. John Hibbs, Director of the School of Transport Studies at the City of Birmingham Polytechnic, extends the analysis to transport in Britain, and warns of obstruction by vested interests.

The international trade periodical *City Transport* recently carried an article entitled 'Choosing the Right Modes for Miami's Public Transport', full of praise for the 'integrated system of rail rapid transit, automated people mover and buses'. The editor had obviously not had the benefit of Gabriel Roth's trenchant analysis of the problems of urban passenger transport,[1] which would have have told him of the name commonly given to Miami Metrorail – 'Metrofail'. Typically of such investment, it cost an enormous amount ($1 billion), and does not go where the people want to go – neither to the Orange Bowl, nor to the airport, nor to the beach. David Stockman, formerly President Reagan's Budget Director, estimated that it would have been cheaper to buy every passenger who uses it a new car every five years for the next 50 years. Yet the Detroit 'People Mover' will be worse: the subsidy of some $14,000 per passenger would buy each of them two 'economy' cars and leave money over for their petrol.

The measured anger that arises from Mr Roth's book is matched by a rigorous analysis of the causes of such a large-scale waste of resources, and by serious proposals for an alternative, based on a radical assessment of the demand for movement in cities. Roth recognises the inescapable fact that what people want of urban transport is best provided for many by the private car, which in an increasingly affluent society will almost inevitably become the most preferred supply. But he recognises, too, that the finite availability of capital, and its opportunity cost, make the unlimited expansion of urban road space impossible, so that some form of shared transport becomes an economic necessity. Roth further identifies the economic folly of pricing the use of scarce road-space at zero at the margin;[2] he concludes that reform of the way in which roads are paid for by the people who 'consume' them must be a priority.

> *private ownership for efficient transport*

The real bite of Roth's excellent paper lies in its fully documented examination of the disastrous consequences of state and local government intervention in the market, which he shows comprehensively to have been the origin of the public transport morass in American cities. Although he draws upon experience from many places where 'public light buses', as minibuses are called in Hong Kong, provide alternative and profitable transport, his case rests upon foundations more secure than mere examples, such as Hong Kong or even Buenos Aires, which can easily be written off as irrelevant by people who see them as exotic behaviour in far-away places. He stresses the importance of four characteristics of an efficient urban public transport system:

- private ownership,
- the use of small vehicles,
- the use of small private firms, and
- the use of route associations;

and while he observes the incentive of the private sector firms to keep costs down and quality up, he shrewdly remarks that 'private operators [. . .] have another advantage over their public sector counterparts They do not have to get re-elected'

It is here that the benefits of change in the British system are beginning to be seen, since a move (albeit partial) was made to reinstate a market for urban bus operation in 1985 Roth's argument for small buses would have been strengthened, yet modified, if he had included the remarkable impact of minibus operation in Britain, which has radically changed the image of public transport in cities from Exeter to Manchester strengthened, because (in the words of the trade fortnightly, *Bus Business*) operators are starting minibus services 'with the kind of panache likely to win them new friends among people who long since abandoned – or perhaps never had – any notion that bus travel was for them', modified in the light of the 'Magic Bus' in Glasgow, the success of which has something to do with retaining conductors on traditional double-deckers – and also with a touch of marketing panache

half-hearted reform

Yet the British system still suffers from the political pressures of the desire for re-election, so that American observers who come over to examine it should brief themselves carefully As I predicted last year,[3] the new system is showing tendencies to produce more regulation than the 1985 Transport Act set out to remove, and this development is making itself felt in two ways

First, the powers and duties of local authorities in providing subsidies are being used in some places to intervene in the market, so that some of the county Co-ordinating Officers and the Passenger Transport Executives that the Act left in place are behaving as if they were operators in their own right, even to the extent of developing their own market image Highly bureaucratic, they seem unable to trust the trade, even calling for guarantees of performance before accepting tenders to provide subsidised services In other examples they are deciding, on unknown criteria, that a higher frequency is required on some route or other, and calling for tenders to run in competition with an existing service that is already commercially successful

Second, the reforms of 1985 were half-hearted where the bigger cities were concerned Faced with the overwhelming conclusion of both operators and academics that there are very limited economies of scale in the bus industry, the then Secretary of State for Transport, Nicholas Ridley, bravely insisted on the break-up of the state-owned National Bus Company before its privatisation, a process that is still under way Sadly, he had not the courage of his convictions about the municipal operators, and the consequent weaknesses in the Act are becoming plain In each of the former Metropolitan Counties, and in the Strathclyde Region in Scotland, the 'successor companies' are still gigantic by comparison with the subsidiaries of the NBC, and still subject to the control of the politicians who make up their 'boards of directors' Only the proviso that they must be financially viable (the politicians may bail them out once only) gives some discipline to their management, but this stipulation is hardly that which, in Roth's words, applies under full private ownership, where 'wasteful decisions [ ] mean lower profits, and, therefore, less income'

All the same, the British reforms have brought about improvements, even if they may not be obvious on the streets of some cities, where managers seem still to be blinded by a tradition of 'municipal socialism' The contrast with the situation in the USA, the supposed home of free enterprise, is poignant, for there the providers of urban transport have had franchised monopolies from the outset When they failed to cover their costs, not despite but because of this protectionism, they were acquired by local government and, from 1964, given federal financial support As in the UK after 1968, increasing application of taxpayers' money was then matched by a consistent fall in the use of the buses, and an even more drastic decline in market share In the UK, for the last two years, the total number of passenger-miles by bus has evened out, perhaps because of the freedom given to British transport managers to exploit price discrimination under the 1980 Transport Act, a liberty that has never been available in the USA

If the warnings in Gabriel Roth's paper were heeded, they could save millions of pounds and dollars in mistaken investment It does not follow that all urban rail-borne transport is undesirable, for land in cities is inevitably in short supply, and the pricing of road-use would be a powerful signal for the accumulation of capital for investing in rapid transit when the high premium on road users had made plain the attractiveness of an alternative It might well have generated the funds for building the Docklands Light Railway, in East London, which is in any case intended to be self-sufficient But alternatives do exist, and Roth presents some of them in his book Busways, for example, might be built for the use of minibuses in competition There is a busway system at Runcorn, in the North-west of England – so why not give the idea a try elsewhere? Busways do not require an all-inclusive system but merely an investment along a few key corridors With adequate policing (to eliminate the parking of cars and vans), the bus lane in the Finchley Road, London, is a good example of what could be done it can readily be imagined with a two-minute headway of minibuses, operated (as in Buenos Aires) by small firms working together in a route association

small firms could run busways

Surprisingly, Mr Roth omits one more powerful argument against high-tech and high-investment 'solutions' to the difficulties of urban transport the question of equity The application of federal and state or municipal funds in the USA has not prevented the run-down of public transport in the deprived areas of cities (where the iniquitous flat-fare system played its part), but the waste of government funds has, in practice, gone to benefit a minority for whom subsidy could hardly be justified on any social grounds (their political pull may be another matter) A public-transport policy that applies taxation to give such heavy subsidies to the longer-distance riders, who make up the majority of rail travellers and who are far from being disadvantaged, carries with it a regressive transfer payment that is impossible to defend

transport subsidies help the rich

Rail-bound transport may be argued to be inherently monopolistic, and yet it seems to carry a cachet of respectability that is denied to minibuses, shared taxis and all the other potential sources of market-oriented supply The manufacturers of railways and rapid transit systems are large undertakings, with large work-forces, and considerable vested interest in maintaining this respectability, minibuses involve comparably far less investment Yet can this distinction be all – are there some psychological factors in urban transport that economists have yet to comprehend? If there are, the lucidity and power of reasoned argument and the direct experience of deregulation in Britain may not be sufficient to overcome the prejudice that informs the *status quo* EA

[1] *Private Sector Alternatives in Urban Transportation*, National Center for Policy Analysis, Dallas, Texas, 1987

[2] A point emphasised in John Hibbs, *Transport without Politics?*, Hobart Paper 95, IEA, 1982, where it was seen as a prerequisite of a market economy for urban transport in all its forms, including the private car

[3] 'Transport Regulation An Ugly Head Raised Again', *Economic Affairs*, Vol 6, No 5, June–July 1986